FREE MARKET CONTRACT LAW



The Asia Foundation

PHNOM PENH

KINGDOM OF CAMBODIA

First Edition 1997

FREE MARKET

CONTRACT LAW

The Asia Foundation

First Edition
1997

This publication was made possible through support provided by the U.S. Agency for International Development under the Cooperative Agreement Number 442-0111-A-00-6509. The opinions expressed herein are those of the author(s) and do not necessarily reflect the views of the U.S. Agency for International Development or The Asia Foundation.

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Printed in the Kingdom of Cambodia in 1997
by Phnom Penh Printing Shop
#98 Preah Sihanouk Blvd. Phnom Penh

DEDICATION

This book is dedicated to Cambodians who work in difficult circumstances to promote justice and legal development in their nation.

PREFACE

I. What Is This Book?

This book is an attempt to introduce basic principles of free market contract law, in order to contribute to the legal and economic development of Cambodia. The book is published in Khmer and English. We hope it will be useful to those who learn, teach and practice law. We believe it could be used as a textbook for legal training, both in university-level law courses and in independent legal education programs; as a basic reference for law teachers, students and practitioners; and by members of the general public who wish to learn more about contract law.

We must stress what this book does not try to do. It is not intended to be a scholarly study of contract law. Though the book is substantial, its focus is not on examining every aspect or detail of the subject covered, but on examining fundamental ideas at some length. Moreover, the book does not attempt to summarize or state precisely the law in any particular jurisdiction. It is primarily based on the common law tradition, for reasons explained in detail below. It does not generally focus on the hardest cases, nor on the complex policy concerns such cases may reflect. It does not attempt to develop analytical skills by burying key information in a mass of difficult, oblique, or marginally relevant material. Instead, the book tries to impart some basic legal principles and policy issues, as clearly and simply as accuracy allows.

This book was created as part of the Certificate in Contract Law Program conducted by The Asia Foundation from 1994 to 1996. The Program was provided for students with positions in the Cambodian government, courts, educational institutions, non-governmental organizations, and the private sector. It included substantial training in Cambodian contract law, free market contract law, international contract law, contract forms, drafting and negotiation, and dispute resolution. It was conducted at the request of and in cooperation with the Ministry of Justice of Cambodia, with generous support from the United States Agency for International Development. The Program and this text were developed by a team of Cambodian law teacher-translators, data entry specialists, international attorneys, and others.

II. How Can Readers Use This Book?

We believe this book can be used in a number of ways. The book is intended primarily to assist in legal training, though it could also be used as a reference work or by those who simply wish to learn more about contract law.

We realize that it may be too extensive for some training programs. If that occurs, we have several suggestions. The text tries to work on three levels at once. First, the entire text is intended as a fairly detailed treatment of some general contract law principles. Second, we have attempted to communicate as many basic ideas as possible in Chapter 1 ("Basic Aspects of Contract Law"), which introduces and summarizes the full text. That Chapter could be used as a more concise introduction to the subject. Third, an even more concise summary of very basic aspects of contract law may be found in Sections 1.1-1.2 of Chapter 1. Those first two Sections introduce and summarize Chapter 1 itself. We suggest that readers select the approach that fits their needs.

We hope other elements of the text will also promote easier understanding for those studying law. In order to guide the reader, we have tried to use as many section headings as possible. In addition, rather than merely identify topics in the section headings, we have tried to communicate as much basic information as is practical. These section headings also appear in the Table of Contents. They could be used as a very basic summary of many of the most important ideas in the text.

We have tried to write the book in a straightforward and engaging way. It includes as much explanation of technical ideas as was practical, frequent repetition of key points, emphasis of important words and points through extensive bold and underlined text, and hundreds of basic examples.

In addition, we have included a number of special features that we hope will make the basic aspects of contract law more transparent. These features include the many Illustrations, Case Studies, Definitions, and Additional References, which attempt to present material in a more concise, practical, or graphic manner than the main body of the text can, and to make it easier to use.

The text does not generally pursue the most complex legal policy concerns. However, it does try to promote consideration of fundamental questions of legal policy. This occurs primarily through the "Why Is This Important?" boxes. These explore some of the apparent reasons for the legal principles discussed. They also try to provoke discussion about whether the rules presented are appropriate, with an emphasis on the practical effects of those rules and potential alternatives.

This book is based primarily on the common law tradition, for reasons explained in detail below. However, the text also tries to provide a comparative perspective, particularly through the Cambodian Law Perspective and Civil Law Perspective boxes at the end of every Chapter. Although it appears to us that there are few truly significant differences as to substantive contract law among the traditions, these boxes try to explain important differences of which we are aware.

Finally, for those who may wish to use the book as a reference work, we hope the Table of Contents, Bibliography, Glossary and Index will be useful guides to finding information about particular topics. In addition, the many Additional Reference headings within the text direct the reader to other portions of the book which also deal with the matter under discussion.

III. Why Does This Book Take the Approach It Does?

In creating this text, we had to make a number of decisions about what approach to take to various legal and other issues. We should try to explain the most important of these decisions.

First, we should note the comparative aspects of this work, which were mentioned above. As readers probably know, common law and civil law may be the two most influential types of legal systems. We believe there are few truly significant differences between the common law and civil law approaches to basic, substantive contract law. However, the legal principles and approaches in this text are drawn primarily from the common law tradition. Where we found what we felt were important differences between the common law and civil law traditions in an area relevant to this text, we tried to explain them in "Civil Law Perspective" sections at the end of each Chapter. We highlighted what we felt were the most significant differences in the main text.

We also included "Cambodian Law Perspective" sections at the end of each Chapter. We hope this will help readers compare the concepts discussed to current Cambodian law, which has traditionally been more influenced by the civil law and socialist legal traditions. This will be further discussed in Chapter 1 ("Basic Aspects of Contract Law").

There are several reasons for our approach. First, this basic approach--primarily common law but comparative--is what the Ministry of Justice of Cambodia requested for the Certificate in Contract Law Program in early 1994. Second, the common law approach to commercial law is now widely influential in Southeast Asia, particularly within ASEAN, and in many other parts of the world. Finally, given the resources available to the Program, it would not have been efficient for those involved to attempt a different approach.

This text draws primarily on the domestic contract law principles of certain jurisdictions, rather than international contract law principles. That is because the book's primary goals relate to the development of domestic Cambodian contract law and practice. International contract law and practice involve a number of special concerns and issues which those responsible for this text felt would be better treated elsewhere. Some of those concerns and issues are addressed in the text International Contract Law, which was also prepared by The Asia Foundation as part of the Certificate in Contract Law Program discussed above.

This text was written in English and translated into Khmer. Great efforts were made to promote accuracy in the translation, including painstaking Khmer to English oral "read-back" of virtually all of the text. The "read-back" process entailed a translator who had not worked on a portion of the Khmer translation translating that portion back to English orally for someone following on the English original, generally a person who wrote or edited that original. However, because of difficulties involved in creating accurate translations of technical legal material between these languages, there may be some inconsistencies between the Khmer and English texts.

Unlike many legal texts, this book rarely cites particular statutes or other legal authorities, except with regard to Cambodian law. Given the basic development goals of the book, its focus on general principles, and the constraints under which it was prepared, we did not feel it would be practical or productive to attempt a rigorous citation to particular authorities. Such an attempt could have made the work impossible to complete with the resources available, increased its size well beyond reason, and provided little or no benefit to most readers. Obviously, most of the ideas in the book did not originate with the Authors or Editor. The book was based on a number of different written and oral sources of information. The Bibliography near the end of the text lists the written works on which we relied most, although a number of others were also consulted. We would like to express our deep appreciation to those responsible for these works, and also to suggest that interested readers consult them for further information.

IV. How Can Readers Tell Us What They Think?

Although those responsible for this book have done their best given the resources available, this First Edition must in many ways be considered a draft edition. It does not purport to be flawless, or even authoritative. The Asia Foundation would very much appreciate being informed of any errors or problems in the book, in receiving suggestions for improvement, and in any other comments from readers. We know such information can improve this book greatly.

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V. Who Created This Book?

Free Market Contract Law is the result of work by a number of persons, from The Asia Foundation and elsewhere. The Certificate in Contract Law Program was founded in early 1994 by Dr. James Klein, then Representative, and J. Ken Bingham, then Law Instructor, of The Asia Foundation. Their vision and guidance are also primarily responsible for the creation of this book. A fuller list of those Asia Foundation personnel who contributed substantially to the book:

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We also wish to thank all the other personnel at The Asia Foundation who assisted in the production of the book.

Many others made significant contributions to this book. First, the book would not have been possible without the generous support of the United States Agency for International Development (USAID) / Cambodia under the terms of Grant Agreement Nos. 442-0111-G-00-2382 and 442-0111-A-00-6509. We also wish to thank the approximately 200 Cambodians who were participants in the Certificate in Contract Law Programs between 1994 and 1996. They contributed to the development of this text through discussion both in and out of class. The book benefited from the consistent support of the Program by the Minister of Justice of Cambodia, H.E. Chem Snguon, and the Ministry of Justice, and by the Minister of Education of Cambodia, H.E. Tol Lah, and the former Minister of Education of Cambodia, H.E. Ung Huot, and the Ministry of Education. In 1994, the University of San Francisco School of Law sent two Legal Interns and a Law Instructor in part to assist with the book. Lany Trinh and the Khmer Socio-Economic Development Research Association provided helpful research about contracts in Cambodia. Margo Grant and Sarika Studio made videos of many of the Case Studies, and helped us understand how they could work better. Sandra Jacobs Summers donated a great deal of her time to the completion of this text. The book benefited from her extensive assistance in desktop publishing and graphics, as well as her valuable editorial and general policy advice. Finally, we wish to thank everyone else who assisted us in any other way.

Harry Jacobs Summers

Editor

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CHAPTER ONE

BASIC ASPECTS OF CONTRACT LAW

1.1 Introduction: A Contract Is an Agreement the Law Will Enforce

A contract is an agreement the law will enforce. Because contracts are important in the modern world, the law that governs contracts is also important.

Unfortunately, contract law can also be complex. So this book explains some general principles of contract law. The book tries to make these principles as easy to understand as it can.

1.1a How This Chapter Works

This first Chapter summarizes some basic aspects of contract law. In doing so, the Chapter actually tries to achieve three different things at once.

First, Chapter 1 is an introduction to this entire book, which is 11 Chapters long. The whole book is designed to be a textbook for a fairly long study of free market contract law, and to be a reference work.

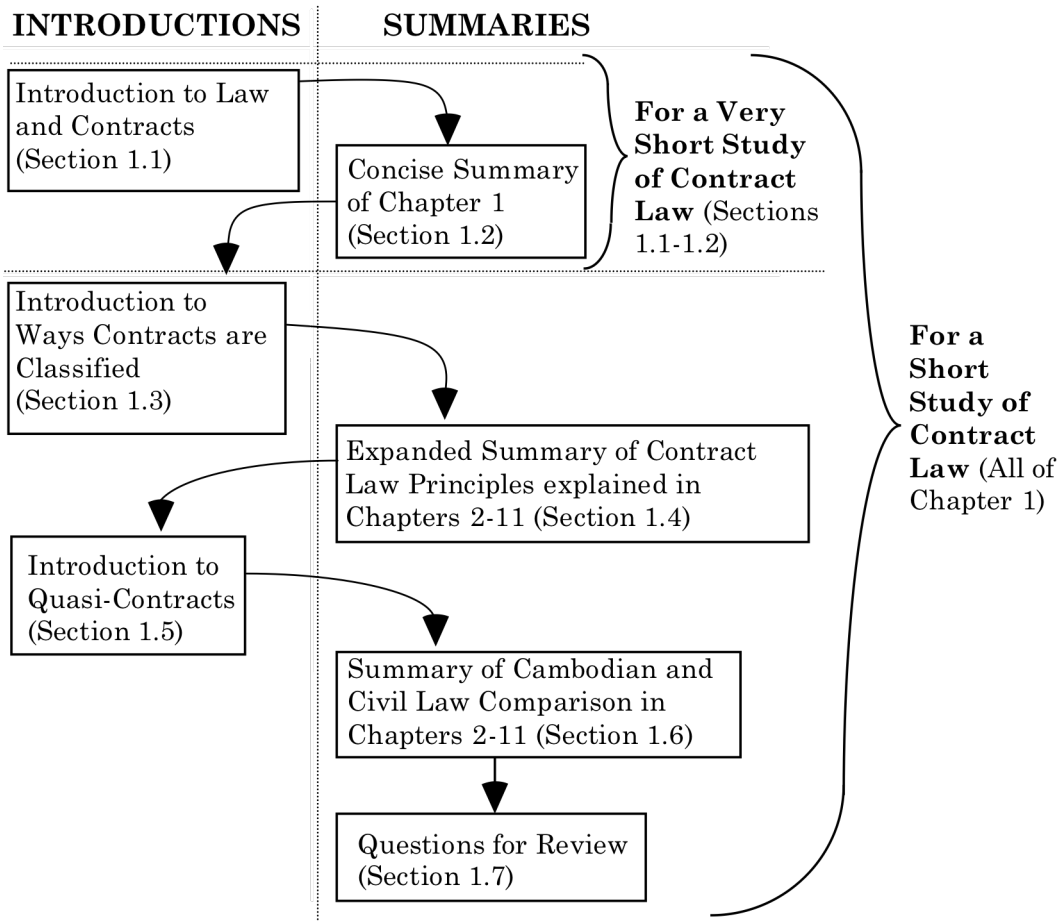
Second, Chapter 1 tries to summarize some basic aspects of contract law. In this regard, Chapter 1 could be used by itself as a textbook for a shorter study of contract law, and as a shorter reference work.

Third, the first part of Chapter 1 tries to concisely summarize some very basic aspects of contract law in an even shorter format. It does this by providing in Section 1.1 a brief introduction to law and contracts, then in Section 1.2 summarizing Chapter 1 itself! So Sections 1.1-1.2 could be used by themselves as a text for a very short study of contract law, and as a quick reference. These first two Sections also provide a brief overview of the rest of the Chapter and the book.

In its attempt to work on three levels at once, Chapter 1 alternates between introductory material that should help readers understand what follows in the rest of the book, and summary material that tries to provide readers with an overview of what follows in the rest of the book. Although it may seem a little confusing, this alternating structure is designed to try

to address the different needs of a variety of potential readers. The following chart illustrates the structure of Chapter 1.

Illustration: How Chapter One Is Organized



Section 1.1 now turns to a basic introduction to law and contracts in free market jurisdictions. In particular, Section 1.1 will now briefly discuss:

(1) why contract law is important (Section 1.1b);

(2) the role of law and courts in society (Section 1.1c); and

(3) contract law in major legal traditions (Section 1.1d).

1.1b Contract Law Is Important

Contract law is one of the most important of all legal subjects. Contracts control most important economic transactions in the world.

They guide the activities of businesses, governments, and individuals. So contracts are crucial to the development of societies.

*** ***WHY IS THIS IMPORTANT?*** Why is contract law important?

Contract law is important for many reasons. Contracts are essential to the activities of businesses, governments, and individuals in free market societies. Respect for contracts can aid investment and growth, which generally lead to a more prosperous society. So the basic policy in free market nations is to promote the performance and enforcement of contracts.

Unfortunately, as we all know, dispute is often present in human relations. And parties sometimes disagree about the formation, meaning, or performance of their contracts. Such disputes can be complex and difficult to resolve. Resolving them in a fair, efficient way is the task of contract law. That is why it is so important that people in business and government--and other individuals--understand contract law.

Contract disputes occur in a wide range of areas, because contracts are used in so many different aspects of life. Of course, the free market economy operates to a large extent through contracts. Business organizations--from small family businesses in local markets to the largest multinational corporations--use contracts to buy and sell raw materials, supplies, and services. Farmers make contracts to buy the equipment and supplies they need to grow things, and to sell what they produce. It is hard to imagine a business surviving without using contracts. This is because the main goal of business is to make money, and it is difficult to do that without using contracts to trade things.

Contracts are also crucial in the activities of governments in trying to protect and improve the well-being of their people. Governments make contracts to buy what they need to operate the different branches of government; to keep order and protect the public from various dangers; to build key elements of the nation's infrastructure, such as railroads and airports; to control the nation's natural resources; and sometimes to hire private parties to help them perform certain government functions. Governments also make important contracts with other governments (such as treaties) about a wide variety of matters. These matters range from trade issues to environmental standards, from human rights to peace accords that resolve wars.

For individuals, contracts make it possible to reliably get food, shelter, health care, work, education, transportation, and recreation; to marry, raise children, and care properly for families; and even to affect events after their deaths! In fact, for most people, it would be difficult to go through even a short period of life without making contracts.

Of course, one reason the importance of contracts may not be obvious is that making contracts is so common. It happens so much, and in so many different situations, that people making contracts often do not even realize they are doing so! For example, if a person buys a bowl of noodle soup for breakfast at a market stall, he has actually made a contract. The buyer of the soup has agreed to pay a certain amount of money for the soup, and the seller has agreed to provide the soup. In fact, this is probably a valid, oral, bilateral contract. There is no need to understand these legal terms yet. The point is only that even such a common act as buying soup for breakfast actually involves making a contract.

Even contracts like the soup example above, which may seem simple, are governed by the legal principles discussed in this book. For instance, in the soup example, suppose the buyer used a threat of violence to compel the seller to sell him the soup. In that case, the contract would not be valid, because of a formation problem: duress. If it was not clear which soup the parties meant, there might be interpretation problems. If the seller provided the wrong soup, defective soup, or no soup, without a legal excuse, the seller would have breached the contract. In that case, the buyer could ask a court for a remedy. So even this small transaction could involve legal problems. Contract law tries to resolve these problems.

1.1c The Role of Law and Courts in Society

In contract law, as in other legal areas, the law tries to provide some fair, efficient general rules to guide people's conduct. In general, governments and courts make these rules. Courts apply them in specific cases.

These rules often mean that a party has rights.

*** **DEFINITION:** A **right** is basically the legal ability to do or not do something, including the ability to control the acts of others.

Where one party has a right, another party generally has a duty.

*** **DEFINITION:** A **duty** is basically a legal obligation to do or not do something.

For example, if a citizen has a legal right to speak freely, then that citizen's government generally has a legal duty to allow him to speak freely. And if Borin has a legal right to receive 1,000 riels from Samen under a contract, then Samen has a legal duty to provide 1,000 riels to Borin.

For any society, it is very difficult to create and apply fair, efficient legal rules--to achieve justice. So law is not always successful at achieving this goal. This is true even though law is often complex and hard to understand, and even though law has been developing in different societies for thousands of years. Law is not always as sophisticated in resolving problems as

people wish. And there are certain human problems--such as poverty, ignorance or racism--which law alone may never be able to "solve!" These kinds of problems may be too complex, too personal, or otherwise too difficult to resolve with general legal rules alone. Law is a useful tool, but it cannot be used for everything.

Because law is complex and its goals hard to achieve, there is often disagreement among different people--particularly those in different places, cultures, or times--about whether particular legal rules are appropriate. One result is that contract law changes over time. And it often varies from one legal jurisdiction to the next. This is a natural part of the evolution of legal systems. However, it makes it very important to check the current local law relevant to any particular problem. This text presents only some general ideas about contract law. It does not state the current law in any specific jurisdiction.

It is also important to understand what this text means when it refers to "jurisdictions." The word "jurisdiction" has several meanings. For example, it can mean the extent of a particular court's power to decide cases. A court may have the "jurisdiction" to decide certain types of disputes, such as maritime or labor cases. But in this book, the term jurisdiction will generally have the following meaning.

*** **DEFINITION:** A **jurisdiction** is, among other things, a geographical unit in which courts apply a particular set of legal rules.

Legal rules generally differ to some extent in different jurisdictions. Often, an entire nation will be a jurisdiction with regard to the set of legal rules that courts apply to contracts. That entire nation will apply the same contract law rules. But in some cases, units that are only parts of nations--such as provinces or states--may each have their own sets of legal rules for contracts. When this text refers to "many jurisdictions," or "some jurisdictions," it means these distinct units, whether they are nations, provinces, or states.

This text will often discuss courts, and how they think about and resolve contract disputes. However, parties often choose methods of resolving contract disputes besides court adjudication. These are sometimes called methods of alternative dispute resolution, or "ADR." ADR occurs only where the parties to a dispute agree to it. ADR in one form or another has actually existed for thousands of years in most societies. Parties who have or may have a contract dispute sometimes choose ADR because it can be faster, cheaper, easier, more flexible and less adversarial than adjudication. However, ADR is not always appropriate--it depends on the situation. ADR methods can be classified by



the different role of the neutral third party, or "neutral," who helps parties resolve their dispute. In many jurisdictions, the major forms of ADR are:

(1) arbitration (with an active neutral (an "arbitrator") who applies legal rules, and who may have the power to impose a solution on the parties);

(2) mediation (with a less active neutral (a "mediator") who enforces basic rules, offers opinions and proposes solutions);

(3) conciliation (with an even less active neutral (a "conciliator") who enforces basic rules);

and (4) negotiation (with no neutral).

The references to courts in this text could often apply to arbitrators. This is because arbitrators try to resolve contract disputes using legal rules, and they may have the power to impose legal solutions on the parties involved. But for ease of reference, the text will usually refer only to courts.

1.1d Contract Law in Major Legal Traditions

As noted above, the law differs to some extent in different jurisdictions. However, it is also important to understand that there are some major legal traditions that have been influential in many jurisdictions throughout the modern world.

Major legal traditions include the civil law, common law, Islamic, and socialist legal traditions. Islamic legal systems exist in some nations in which most citizens are Muslims. Socialist legal systems exist in some nations with socialist systems of government. A detailed discussion of these important traditions is beyond the scope of this text.

Perhaps the two most influential traditions in the world are the civil law tradition and the common law tradition.

The common law tradition basically originated in English law. It is followed today by many nations, including Singapore, India, Australia and the United States. Very generally, the common law approach theoretically gives more power to judges to "make law" in areas where legislation is absent or unclear. Common law courts use the prior decisions of other courts as precedent to help them decide current cases. This precedent may be binding or only persuasive, depending on the relationship of the courts involved.

The civil law tradition originated in Roman law. It is followed today by many nations, such as Thailand, Indonesia, Germany and France. The civil law tradition is often viewed as giving more power to the legislature and to detailed codes drafted by that legislature, and as giving judges little or no power to "make law." So the ability of civil law judges to use prior court decisions as precedent on which to base new decisions is theoretically limited.

Today, more nations may be viewed as following the civil law tradition than the common law tradition. And the formal legal structures of Cambodia have to date been more influenced by the civil law tradition than the common law tradition.

These two major legal traditions have a great deal in common. Many feel that their approaches are gradually moving closer in important ways. Common law legislatures enact many detailed statutes. Common law judges must apply these statutes to disputes they resolve, if the statutes are relevant. Of course, no statute--no matter how detailed--can specifically govern all potential legal events in a particular area! So judges in civil law jurisdictions arguably "make law" to some extent when they decide legal disputes in areas where legislation is absent or unclear. Of course, their decisions do not have the same weight as precedent that common law court decisions do.

In addition, in the area of contract law, common law principles are influential. The common law tradition is a major source of international contract law. And many Southeast Asian jurisdictions with powerful, quickly growing economies--such as Singapore, Malaysia, and Hong Kong--follow the common law tradition.

As explained in the Preface, the main focus of this text is basic contract law principles in the common law tradition. However, there appear to be relatively few major substantive differences between the approaches of the civil law tradition and the common law tradition to contract law. In this context, a "substantive" difference is a difference in the actual rules that govern contract formation, interpretation, performance and remedies. By contrast, differences that relate mostly to rules about the procedures for resolving disputes, where law originates, or the general powers of judges or legislatures are not substantive contract law differences. In any case, where important substantive differences seem to exist, this text tries briefly to explain them. Each Chapter contains a Section which examines such differences in the approaches of the civil law tradition and the Cambodian legal tradition.

1.2 Concise Summary of Basic Aspects of Contract Law Discussed in Chapter One

Section 1.2 is a concise summary of the basic aspects of contract law discussed in Chapter 1. This concise summary is designed mainly for readers who have time only for a very brief study of the contract law principles



discussed here. But it should also serve as a quick overview of these ideas for those who are able to read further. In particular, Section 1.2 contains:

(1) a discussion of ways the law classifies contracts;

(2) an explanation of six basic requirements many jurisdictions have for a valid contract (real agreement, consideration (common law only), capacity, legality, formality, and no other formation problems);

(3) an explanation of other key aspects of contract law (interpretation, performance, remedies, and third party rights and duties);

(4) a discussion of other features of this Chapter (an introduction to quasi-contract, and Cambodian and civil law perspectives on contract law);

(5) an illustration of very basic ways to analyze contract law problems; and

(6) a discussion of the questions for review at the end of all Chapters in this text, and some quick questions for review of Sections 1.1 and 1.2.

Section 1.2 is intended only to introduce quickly some basic ideas. These ideas are too numerous and complex to explain fully in so small a space. In order to understand them better, readers are urged to read the rest of Chapter 1, and if possible the rest of this book.

A simple example may help explain better how some of these principles work. Suppose that, one day in 1997 at the market, Vantha says to Samneang: "I offer to sell you one kilo of rice for 2,000 riels. I will give you the rice first, then you pay me right away." Samneang promptly says: "I accept your offer." Vantha and Samneang are 30-year-old women. Section 1.2 will use this rice example to explain many of the ideas discussed.

1.2a Ways the Law Classifies Contracts

As noted above, a contract is an agreement the law will enforce. In explaining this key idea, this Chapter first discusses how the law classifies contracts. Contracts may be classified by: (1) enforceability, (2) basic nature, (3) stage of performance, and (4) form.

(1) **Enforceability** -- When classified by enforceability, contracts may generally be:

- Valid -- This means that the contract is enforceable in court by all parties to the contract.

- Voidable -- This means that a contract is enforceable, but at least one party to the contract can avoid (not obey) it. That party can enforce the contract against the other party, but the other party cannot enforce it against the first party unless the first party chooses to proceed with it! Voidable contracts can occur because one party is the victim or subject of certain formation problems, such as that one party made the contract under duress or lacked capacity.

OR

- Void -- This means that the "contract" is not enforceable by anyone. This can occur where certain formation problems exist, such as a lack of real agreement or legality. In fact, since a contract is defined as an agreement the law will enforce, a "void contract" is not really a "contract" at all!

These fundamental categories are discussed more fully in Section 1.3a.

For instance, in the rice example above, Vantha and Samneang agreed that Vantha would sell Samneang one kilo of rice for 2,000 riels. If this agreement was valid, as it seems to be, then either party--Vantha or Samneang--could ask a court to enforce it. The contract would bind both of them. However, suppose the contract was voidable, perhaps because one of the parties lacked capacity. Then it would be enforceable but at least one party could avoid it. Suppose the contract was voidable because Samneang was mentally incompetent when she made it. Then Samneang could enforce the contract--but Vantha could not enforce it against Samneang unless Samneang chose to proceed with it. Finally, suppose the agreement was void, because it was illegal to sell rice. Then neither Vantha nor Samneang could enforce the agreement.

(2) **Basic Nature** -- When contracts are classified by their basic nature, they may be bilateral or unilateral. In common law jurisdictions, bilateral contracts are basically an exchange of promises, while unilateral contracts are an exchange of a promise for an act. Bilateral contracts are far more common, especially for important commercial contracts, since they provide both parties with the security of a promise that what the party wants done will be done. Bilateral contracts generally occur where one party makes an offer requesting a promise, and the other party properly accepts the offer by making the promise requested. Unilateral contracts exist in special situations where they meet the needs of the parties. They typically occur where one party makes an offer requesting a specific act, and the other party accepts by actually performing that act. Examples of unilateral contracts include many public offers and client-broker arrangements. Civil law jurisdictions may define bilateral and unilateral contracts differently. Section 1.3b discusses in more detail how contracts are classified by their basic nature.

For example, the rice contract above was a bilateral contract. It was bilateral because it was an exchange of Vantha's promise to supply rice and

Samneang's promise to pay 2,000 riels. The contract occurred because Vantha made an offer requesting a promise, and Samneang properly accepted by making the promise Vantha requested.

(3) **Stage of Performance** -- When contracts are classified by their stage of performance, they may be executed or executory. Executed contracts are those that the parties have fully performed. Executory contracts are those that have not been fully performed by all parties. This is explained in more detail in Section 1.3c.

For instance, in the rice contract example above, the contract was executory as it was described, since it had not yet been fully performed by both Vantha and Samneang. However, suppose Vantha supplied the rice to Samneang, and Samneang paid 2,000 riels for it. Once those acts occurred, the contract would be executed.

(4) **Form** -- Finally, Section 1.3d discusses how contracts are classified by their form. Contracts may be express (in words) or implied (from conduct). Implied contracts are enforceable even though the parties do not use words to make them, as long as they meet all the requirements for an enforceable contract. In implied contracts, the real agreement courts normally require may not always be obvious. Courts analyze whether the parties have really agreed based on whether a reasonable person would think the parties had done so--an objective standard. Contracts may be partly express and partly implied, where parties state some terms but not other terms. In this situation, terms can often--but not always--be implied by law, based on the circumstances.

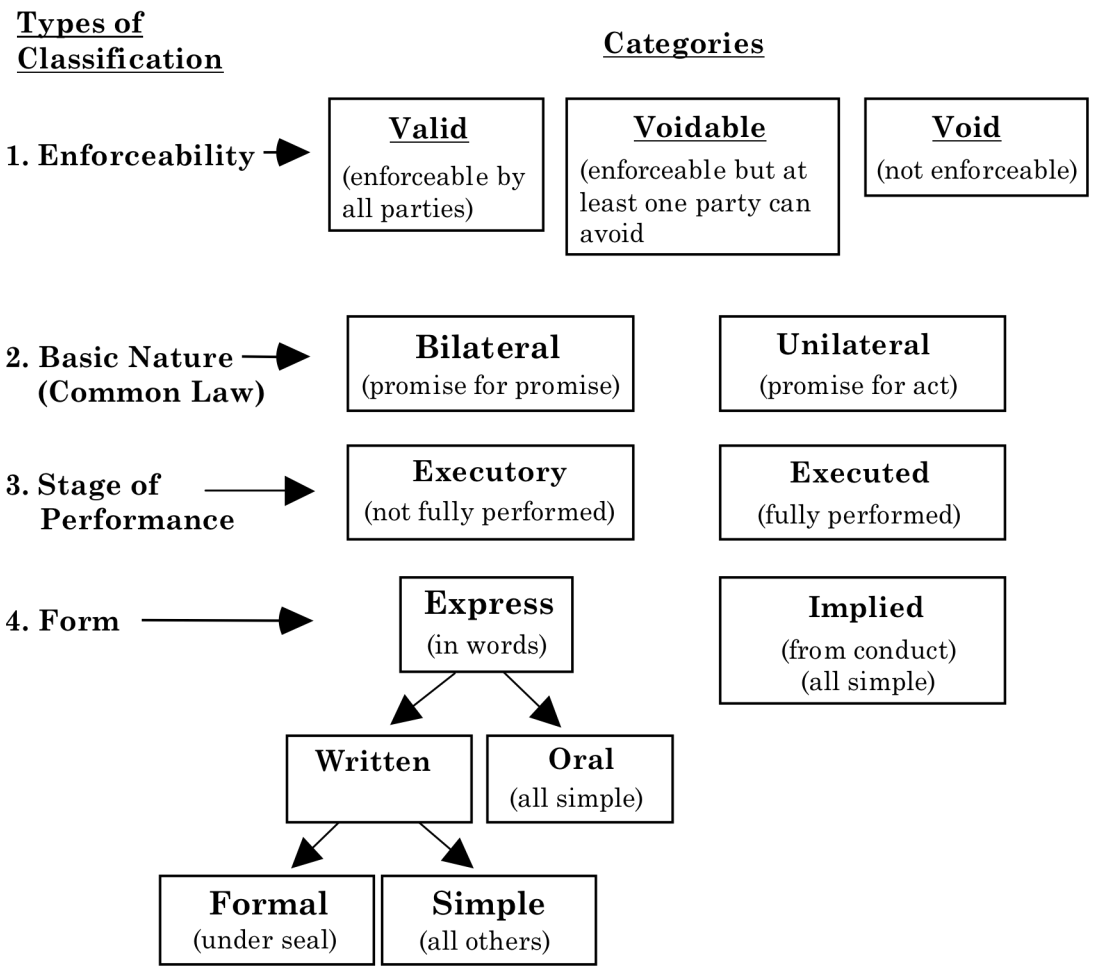
Express contracts may be written or oral. Oral contracts are generally as enforceable as written ones, and they may actually be more practical for small, common transactions. However, many jurisdictions do require certain important kinds of contracts to be written in order to be enforceable. In addition, parties should put all important contracts in writing, even if the law does not require it. That encourages parties to be clearer and more complete in making their agreement, and also provides better proof of the agreement.

Some jurisdictions also distinguish between contracts which are "formal" (made under seal) and "simple" (not made under seal). Traditionally, some jurisdictions said that formal contracts were not subject to the usual common law requirement of consideration (an exchange of legal detriment), and that parties had more time in which to bring claims about formal contracts to court than to bring claims about simple contracts. Many jurisdictions no longer distinguish between formal and simple contracts.

For instance, in the rice example above, the contract between Vantha and Samneang was basically express because the parties made it using words, rather than conduct. If they had used only hand gestures, the contract would have been implied. In addition, their contract was oral, because they used

spoken (not written) words. Finally, the contract was simple, because it was not made under seal.

Illustration: Basic Ways to Classify Contracts



1.2b Six Basic Requirements for a Valid Contract: Real Agreement, Consideration (Common Law Only), Capacity, Legality, Formality, and No Other Formation Problems

Sections 1.2b and 1.2c summarize the 10 important contract law principles explained more fully in Section 1.4 (Sections 1.4a-j), and in the remaining 10 Chapters of this book (Chapters 2-11). These principles govern whether contracts are enforceable; how courts interpret their meaning; how courts analyze contract performance; what contract remedies courts may order or allow; and third party rights and duties. The principles are numbered 1-10 in **bold** print below. The Sections and Chapters which explain them more fully appear in (parentheses).

Often, when courts face a contract problem, they must first consider enforceability. In particular, in order to be valid in many jurisdictions, contracts must satisfy legal requirements in the following six basic areas: (1) real agreement; (2) consideration (common law jurisdictions only); (3) capacity; (4) legality; (5) formality; and (6) other formation problems. Each of these areas is briefly explained below.

(1) Real Agreement -- This requirement generally means that a valid offer must be communicated from one party (the offeror) to another party (the offeree), and that the intended offeree must make a proper acceptance. To be valid, an offer must be serious, definite, reasonably clear, and not ended. An offer can be ended by the offeror, who may revoke it; by the offeree, who ends it when he makes a rejection or a counter-offer; or by some other event, such as lapse, the incompetence of a necessary party, destruction of the subject matter of the contract, or a change in the law. In common law jurisdictions, a proper acceptance of an offer that requests an act--an offer for a unilateral contract--can generally be made by full performance of that act. A proper acceptance of an offer that requests a return promise--an offer for a bilateral contract--can generally be made by communicating the promise the offeror requested in a proper manner. This generally requires that the acceptance be unequivocal and identical to the offer (a "mirror image"), and that the manner of acceptance be reasonable under the circumstances. (Section 1.4a and Chapter 2)

In the rice example above, real agreement appears to exist, because there has been a valid offer and a proper acceptance. Vantha communicated a serious, definite, reasonably clear offer to Samneang for the sale of one kilo of rice for 2,000 riels--an offer for a bilateral contract. Vantha did not revoke the offer. Samneang did not reject it or make a counter-offer. And the offer was not terminated by any other event, such as lapse or the incompetence of one of the parties. So the offer had not ended at the time Samneang tried to accept it. In addition, it appears that Samneang properly accepted the offer. This was an offer for a bilateral contract--an offer that requested a return promise. Samneang was the intended offeree, and she communicated to Vantha the promise that Vantha had requested: the promise to buy the rice for 2,000 riels. Samneang did not express any doubt, or try to change the terms of the offer--her acceptance was a "mirror image" of the offer. And she accepted promptly and in the same manner in which Vantha made the offer (orally), which was reasonable under the circumstances.

(2) Consideration -- Consideration is basically an exchange of new legal detriment between contract parties. Common law jurisdictions generally require it in order for contracts to be enforceable, but civil law jurisdictions do not. This requirement basically means each party must do or agree to do something he did not have to do before. Many exceptions to the requirement exist, such as for promises to make charitable donations. (Section 1.4b and Chapter 3)

Consideration exists in the rice example above. This means only that the parties each have some new legal detriment--that they do or agree to do something they did not have to do before. Here, Vantha has agreed to provide one kilo of rice. Samneang has agreed to pay 2,000 riels. The parties did not have these duties before. So each party has some new legal detriment. There is consideration on both sides.

(3) Capacity -- Adults generally have full capacity to make contracts. Important parties who may lack full capacity include minors and those who are mentally incompetent or intoxicated. Contracts these parties make are often voidable. Parties convicted of crimes may have a limited capacity to contract. Foreigners generally have full capacity to contract. (Section 1.4c and Chapter 4)

Both parties appear to have capacity in the rice example. Vantha and Samneang are both adults, not minors. There is no evidence that they were mentally incompetent or intoxicated when they made the agreement. And there is no evidence that they had been convicted of crimes or were foreign citizens, which in very limited circumstances could affect their capacity. So both Samneang and Vantha seem to have capacity with regard to this contract.

(4) Legality -- Agreements that violate specific statutes or public policy are generally void and therefore unenforceable. Examples of agreements that violate specific statutes are agreements to commit crimes, charge usurious interest rates, or unreasonably restrain trade. Examples of agreements that violate public policy are those to commit torts, or harm the administration of justice or the public service. (Section 1.4d and Chapter 5)

The contract in the rice example above appears to meet the requirement of legality. Contracts to sell rice are generally legal. They do not typically violate statutes or public policy, as agreements to commit crimes or harm the administration of justice might. So Samneang's contract to buy rice from Vantha is probably legal.

(5) Formality -- Both oral and written contracts are generally enforceable. But some kinds of contracts must generally be written to be enforceable. Important agreements which many jurisdictions require to be written include those to transfer a substantial interest in land; those which cannot be performed within one year; suretyship agreements; and those for the sale of goods over a certain monetary amount. (Section 1.4e and Chapter 6)

In the rice example, the requirement of formality is probably met. The type of contract Vantha and Samneang made does not fall into any of the categories of contracts that many jurisdictions say must be written to be enforceable. Their contract for the sale of rice is a sale of goods contract. Many jurisdictions do require that contracts for the sale of goods over

a certain monetary amount be written. However, these amounts are usually far higher than 2,000 riels.

(6) No Other Formation Problems -- Other formation problems may affect whether agreements are valid. Important examples include agreements resulting from mistake, misrepresentation, duress, or undue influence, which are generally voidable. In limited situations, courts may refuse to enforce agreements because they are unconscionable, which occurs where there is extreme unfairness in the process of formation or terms of an agreement. Finally, where a party justifiably relies on a promise, that promise might be enforced under the common law doctrine of promissory estoppel to the extent needed to avoid injustice--even though legal requirements such as real agreement or consideration are not met. (Section 1.4f and Chapter 7)

The contract in the rice example does not appear to have any other formation problems. It does not seem that either party has made a mistake or misrepresentation of fact about the contract; that either party used duress or undue influence to make the other party agree; or that the contract is so extremely unfair in its terms or process of formation that it is unconscionable. Vantha and Samneang appear to have understood the basic nature of their agreement, and to have made the agreement freely. The bargain--one kilo of rice for 2,000 riels--does not seem extremely unfair in 1997. However, suppose this agreement failed to meet a writing requirement. And suppose Samneang told Vantha there was no need for a writing, and Vantha then spent money to travel and buy the rice from someone else. But Samneang refused to accept or pay for the rice, citing the writing requirement. In that situation, there would be no valid contract. But a common law court might enforce Samneang's promise under the doctrine of promissory estoppel (detrimental reliance). That might happen if the court felt Vantha's reliance was justifiable, and that enforcement was needed to avoid injustice. Injustice might exist here because Vantha already spent time and money in reliance on Samneang's promise.

Because all six basic requirements appear to be met, the agreement in the rice example appears to be a valid contract. So either Samneang or Vantha can enforce it in court.

1.2c Other Key Aspects of Contract Law: Interpretation, Performance, Remedies, and Third Party Rights and Duties

Courts often must decide more than simply whether contracts are enforceable. They must resolve other important problems related to contract interpretation, performance, remedies, and third party rights and duties. These issues are introduced below.

(7) Interpretation of Contracts -- Where the meaning of a contract is disputed, courts have many rules to help them interpret the contract. Many courts first try to interpret the contract subjectively (based on the actual intentions of the parties), then if that is not possible objectively

(based on what reasonable parties would likely have intended). Courts try to interpret contracts to be valid and reasonable, and to avoid inconsistency between contract terms. They consider the ordinary meaning of the disputed terms, and surrounding circumstances such as the course of performance, course of dealing, and trade practices. Courts interpret disputed terms against the contract drafter if that is reasonable. Courts may in certain cases supply omitted terms, such as the duty of good faith and fair dealing, and "gap-fillers" for sale of goods contracts. (Section 1.4g and Chapter 8)

For instance, in the rice example above, suppose Vantha delivered brown rice--but Samneang says she wanted white rice. This is an interpretation problem. To solve it, many courts would first try to interpret the contract subjectively, by asking what the parties actually intended "rice" to mean in their contract. In this situation, it might be difficult to tell--especially if both parties claim they meant what they now want! So a court might need to use objective rules of interpretation, which focus on what reasonable people would likely have meant in the same circumstances. These objective rules might include analyzing the ordinary meaning of "rice" in the circumstances, any prior course of dealing between the parties, and general trade practices relevant to the contract. Suppose this analysis showed that, when people asked for "rice" in this market, they meant white rice unless they specifically asked for some other kind. The court would probably find that "rice" in the contract between Samneang and Vantha meant white rice. Another potential interpretation problem in this example would be the parties' agreement that Samneang would pay for the rice "right away." Obviously, this phrase could be interpreted in different ways.

(8) Performance and Discharge of Duties -- In some cases, there is a problem in the performance of duties under a contract. Contract duties do not end until they have been discharged. Whether contract duties have been discharged may require analysis of what the contract requires. Two important parts of this analysis are promises and conditions. Promises are statements that a party will perform a duty when performance is due. An unexcused failure to perform a contract promise as required is a breach. A breach gives the injured party the right to ask a court for a remedy. Conditions are events which are not certain to occur, but which must occur or be excused in order for a contract duty to become due or terminate. Conditions may be stated expressly in the contract, implied-in-fact from the circumstances, or implied-in-law because of legal policy. Conditions may be precedent, subsequent, or concurrent, depending on when they may occur in relation to the duty that depends on them. A duty does not become due for performance until any conditions on which it depends are fulfilled or excused. Conditions are fulfilled by occurrence; complete performance; or in the case of implied-in-law conditions only, substantial performance. Conditions may also be excused, such as by anticipatory repudiation, improper rejection of a tender of performance, or wrongful prevention or hindrance. Duties may be discharged by complete performance, a material breach by the other party, or other events related to performance. They may also be discharged by a later agreement or

statement of the parties, such as a release or a substitute contract. And duties may be discharged by operation of law, such as by impracticability or a final court judgment. (Section 1.4h and Chapter 9)

For instance, in the rice example above, suppose Vantha fails without any legal excuse to provide rice, as the contract requires. This is a performance problem. Obviously, the duties in this contract have not been properly discharged. So courts would ask what did happen. Many courts say that, where a contract requires one party's performance to occur first, that performance is an implied condition precedent to the duty of the other party to perform. This means that, in order for one party's duty to perform to become due, the other party must actually perform first. In this case, Vantha's delivery of the rice was an implied condition precedent on which Samneang's duty to pay depended. This is because the contract said Vantha was to perform first, by providing the rice. But Vantha failed to do that. The result is that Samneang's duty to pay does not even become due! In addition, Vantha's failure to provide the rice as the contract required is a breach of the contract. This is because it is an unexcused failure to perform her promised duties under the contract when they were due to be performed. This breach gives Samneang the right to ask a court for a remedy.

(9) Remedies -- If duties have not been properly discharged, and some remedy is appropriate, a court has several options. It might order a party to pay various kinds of money damages or other types of monetary awards. These include expectation damages, which try to put the injured party in the position he would have occupied if the parties had fully performed the contract; reliance damages, which try to put the party in the position he occupied before the contract or promise was made; restitution damages, which try to compensate the party for the benefit he gave to another party; stipulated damages (damages specified in the contract); and interest. Courts do not generally order punitive damages in contract disputes. Parties can generally recover only damages that are reasonably certain and reasonably foreseeable, and that they could not reasonably have avoided. Courts can also order specific performance--order a party to perform a contract. But common law courts do so only when they think money damages are not adequate, usually because the contract's subject matter is unique, as in the case of land or unique goods. (Section 1.4i and Chapter 10)

For instance, in the rice example above, Vantha breached the contract by failing to provide the rice. That means Samneang has the right to ask a court for a remedy. She could ask a court for different kinds of money damages. In this case, Samneang might consider asking for expectation damages, which try to put her in the position she would have occupied if the contract had been fully performed. To calculate these can be complex. Basically, courts determine the difference between the value of the additional benefits the injured party expected to receive and what he saved by not having to perform his own duties. Here, a court might order Vantha to pay Samneang the difference between the value of the additional benefits Samneang expected

(one kilo of rice) and what she saved by not having to perform her own duties (2,000 riels). Suppose Samneang reasonably paid 2,100 riels to another seller to get the rice Vantha failed to supply. Many courts would say the real value of the additional benefits Samneang expected--the rice--would be 2,100 riels. In that case, Samneang's expectation damages would be 100 riels (2,100 riels minus 2,000 riels). Samneang could probably also recover interest on this amount. Or a court might order Vantha to specifically perform the contract--to actually provide the rice. However, common law courts order that only when they feel that money damages are not adequate, generally because the subject matter of the contract is unique. That would probably not be the case in a contract for common goods such as rice.

(10) Third Party Rights and Duties -- Third parties--those who are not parties to a contract--can have rights or duties under the contract. A contract party may assign his rights or delegate his duties to a third party. Contract rights can generally be assigned. Contract duties can be delegated if the other party to the original contract will still receive the substantial benefit of his bargain after the delegation. A party who delegates a duty remains liable for the performance of that duty. A third party can also have rights under a contract if he is an intended beneficiary. That occurs where the parties to the original contract clearly intended to benefit that third party when they made their contract. (Section 1.4j and Chapter 11)

For instance, in the rice example, suppose that after the contract was made Vantha assigned her right to receive the 2,000 riels to her friend Vandy. Vandy would have the right to receive the 2,000 riels from Samneang, and Vantha would no longer have that right. Or suppose that Samneang delegated her duty to pay the 2,000 riels to Kim Sean, who promised to pay the money. That would mean that Kim Sean would have the duty to pay the 2,000 riels. But in that case, Samneang would still have the duty to pay the 2,000 riels, in the event that Kim Sean failed to do so. Finally, suppose that Vantha and Samneang did not agree that Vantha would provide rice to Samneang in exchange for 2,000 riels. Suppose they agreed that Vantha would provide the rice to Inserey, and that in exchange Samneang would pay Vantha 2,000 riels. In that case, Inserey is an intended third party beneficiary of the contract between Vantha and Samneang. So he actually has the right to enforce the contract--even though he is not a party to it!

1.2d Other Features of this Chapter: Introduction to Quasi-Contract, and Cambodian and Civil Law Perspectives

After its discussion of the general principles of contract law described above, this Chapter introduces the idea of quasi-contract, which is considered one form of restitution. Quasi-contract is a doctrine that courts apply where they cannot enforce a contract for the party seeking help, but they impose contract obligations in order to avoid unjust enrichment. Not all enrichment is unjust. That generally occurs only in certain situations where a party has provided some benefit to another party with a reasonable expectation of

compensation. That might occur where there was no agreement at all; an agreement had a formation or performance problem, such as failure to meet a writing requirement or impracticability; or a breaching party sought restitution. Quasi-contract is explained in Section 1.5.

For instance, in the rice example above, suppose the law did require this contract to be written to be enforceable. And suppose that after Vantha supplied the rice to Samneang, Samneang did not pay. Instead, Samneang correctly said that the contract was actually not valid, so she had no duty to pay. However, even though there was no valid contract, Samneang refused to return the rice to Vantha. In that case, courts would likely say that Vantha could recover the reasonable value of what she had provided to Samneang--the rice--under quasi-contract, in order to avoid unjust enrichment of Samneang. Although there is no enforceable agreement, it would clearly be unjust for Samneang to keep the rice but pay no money for it.

Section 1.6 of this Chapter has a comparative feature which also appears in all other Chapters. This is a brief comparative discussion, which includes "Cambodian Law Perspective" and "Civil Law Perspective" boxes. These Sections discuss how the Cambodian and civil law traditions approach the general ideas discussed in the rest of the Chapter.

It appears that there are few truly significant substantive differences between the common law and civil law traditions with regard to contract law. Some of the most significant differences are that: common law jurisdictions generally require consideration in order for a contract to be valid, but civil law jurisdictions do not; the specific doctrine of promissory estoppel does not appear to exist in civil law jurisdictions; many civil law jurisdictions do not seem to apply any rule directly comparable to the parol evidence rule; and civil law courts are more likely to order specific performance, even where the subject matter of a contract is not unique.

1.2e Illustration of Very Basic Ways to Analyze Contract Problems

The chart below summarizes some of the very basic ways to analyze contract problems which are discussed above, in order to help the reader begin to think about this important process. Of course, to understand these ideas better, it is necessary to read the rest of this Chapter and this book!

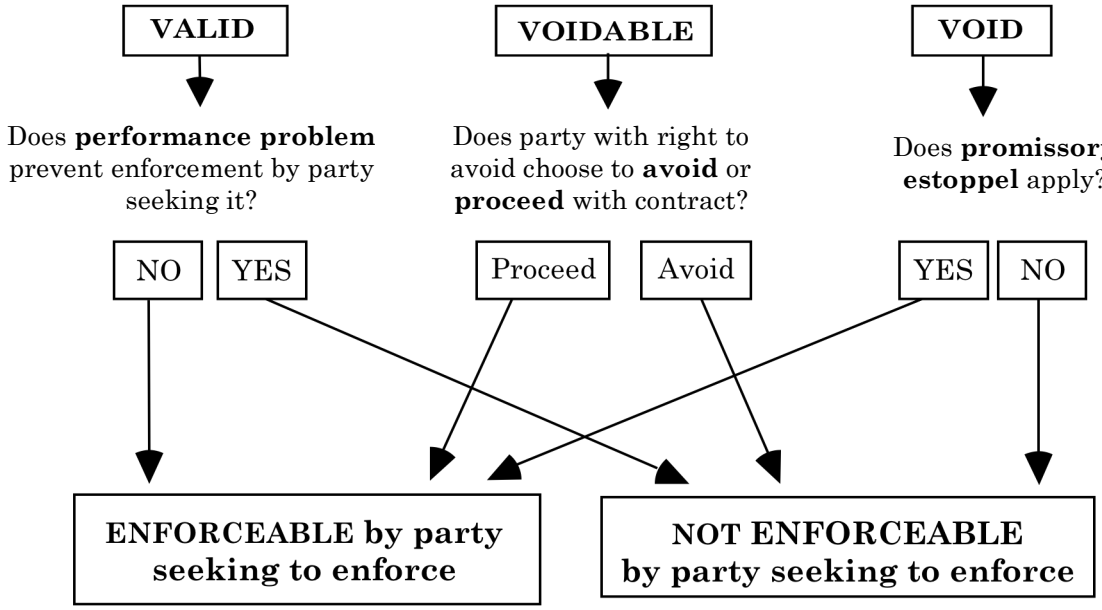


Illustration: Very Basic Ways to Analyze Contract Problems

Does **POTENTIAL CONTRACT** meet
SIX BASIC REQUIREMENTS?

1. **Real Agreement** -- serious, definite, clear offer communicated and open; proper acceptance by complete act or communication of requested promise by intended offeree?
2. **Consideration** -- exchange of legal detriment (common law jurisdictions only)?
3. **Capacity** -- minor, mentally incompetent, intoxicated?
4. **Legality** -- violation of specific statute or public policy?
5. **Formality** -- writing for land transfer, suretyship, time for performance more than one year, sale of goods over certain monetary amount?
6. **No Other Formation Problems** -- mistake, misrepresentation, duress, undue influence, unconscionability, promissory estoppel?

Based on these requirements, is contract **valid, voidable or void**?



Interpretation problem? Court uses subjective, then objective analysis

Performance problem? Duties not properly discharged, perhaps because of breach

Remedy possible, usually money damages or specific performance

Remedy still possible under quasi-contract

1.2f Questions for Review

Finally, Section 1.7 of Chapter 1 contains some Questions for Review. These Sections appear at the end of each Chapter in this book. They are intended to help readers measure their basic knowledge of the topics presented in the Chapter.

Below are some quick review questions for this text up until this point, which could be used for a very short study of contract law. These questions relate to Section 1.1's introduction to law and contracts, and Section 1.2's concise summary of basic aspects of contract law.

QUICK REVIEW QUESTIONS

(1) What is a contract?

(2) Why is contract law important?

(3) Explain four important ways the law classifies contracts.

(4) Explain the six basic elements many jurisdictions require in order for a contract to be valid.

(5) Explain some important ways courts interpret contracts.

(6) Explain how many courts analyze contract performance and discharge of duties.

(7) What remedies might be available in the event of a contract dispute?

(8) How could third parties have rights or duties under a contract?

(9) Explain the doctrine of quasi-contract.

(10) What are some important differences between the approach to contract law discussed in this text and the approaches of the Cambodian and civil law traditions?

*** ***ADDITIONAL REFERENCE:*** Chapters 2-11 of this book explain many of the ideas quickly introduced in Section 1.2 in more detail.

1.3 Ways Contracts are Classified

As noted above, contracts may be classified in a number of different ways. These categories help courts understand the contracts better, and apply contract law more fairly and effectively. Some of the more important

classifications will be discussed in detail below. Specifically, this Section will explain classification by:

(1) enforceability (Section 1.3a);

(2) basic nature (Section 1.3b);

(3) stage of performance (Section 1.3c); and

(4) form (Section 1.3d).

1.3a Contracts Classified by Their Enforceability: Valid, Voidable and Void Contracts

As noted in Section 1.2, perhaps the most important way courts classify contracts is by their enforceability. However, before discussing these categories, it may be helpful to state again the basic meaning of "contract."

*** **DEFINITION:** A **contract** is an agreement the law will enforce.

This definition means that parties can enforce contracts in court, if they wish. That is not true about many statements or agreements that are not contracts.

For example, if Neth tells Roung he wants Roung to pay him some money, that alone is not a contract. It is simply a statement or demand by Neth. A court will not enforce it. And even when Neth and Roung agree about something, they may have an agreement, but not a contract. An agreement is not a contract unless it meets the requirements discussed in this Chapter.

When contracts are classified by their enforceability, there are three basic categories: valid, voidable, and void. In general, a valid contract is enforceable by all parties to it; a voidable contract is enforceable, but at least one party can avoid it; and a void "contract" is not enforceable by anyone. Certain contracts do not fit neatly into only one of these categories--they may have aspects of more than one of the categories. These contracts will be further discussed in the rest of this text. For example, certain contracts may be partly valid and partly void. The three basic categories are explained in more detail below.

(1) A Valid Contract Is Enforceable by All Parties to the Contract

Parties generally try to make contracts they can enforce. So parties try to create valid contracts.

*** **DEFINITION:** A **valid contract** is a contract that is enforceable by all parties to the contract.

Most contracts are valid. However, they are not automatically valid just because the parties want them to be! In order to be valid, contracts must meet a number of legal requirements. In many jurisdictions, contracts are valid only if they meet all of the six basic requirements discussed in Section 1.2:

(1) real agreement (offer and acceptance),

(2) consideration (common law jurisdictions only),

(3) capacity,

(4) legality,

(5) formality,

AND (6) (no) other formation problems.

To be valid, a contract must generally meet all of these requirements. So if an agreement fails to meet even one of these, it is not a valid contract. In these cases, the agreement may be voidable or void.

*** ***CASE STUDY 1***

FACTS Vuth offers to buy Sereya's car. Sereya accepts. They sign a written agreement in which Vuth agrees to buy the car for $5,000. Both parties are mentally competent adults. They both freely make the agreement, with an accurate understanding of the basic elements of the transaction.

QUESTION OF LAW Is this a valid contract?

DECISION Yes. The contract is valid, and enforceable by Vuth or Sereya, because it meets all the requirements for a valid contract.

Agreements are valid--and enforceable by all parties--if they meet all the legal requirements. In many jurisdictions, these are requirements as to real agreement (offer and acceptance), consideration (common law jurisdictions only), capacity, legality, formality, and other formation problems.

In this case, Vuth and Sereya made an agreement for the sale of a car. They appear to have a real agreement, with a valid offer and a proper acceptance. There is consideration, since both have agreed to do something they did not have to do before. Both have capacity, since they are competent adults. The agreement appears to be legal, since car sales are generally legal. Any formality requirements as to this sale of goods agreement appear to be met, since the agreement is expressed in a signed writing. And there seem to be no other formation problems, since both parties made the agreement freely and with a basic understanding of it. This is a valid contract. Either Vuth or Sereya can enforce it in court.

*** ***ADDITIONAL REFERENCE:*** Chapters 2-7 of this book explain the basic requirements for a valid contract in many jurisdictions.

(2) A Voidable Contract Is Enforceable, but At Least One Party to the Contract Can Avoid It

Sometimes there is a formation problem that creates unfairness to one of the parties to a contract. In these cases, contracts are often voidable.

*** **DEFINITION:** A **voidable contract** is one that is enforceable, but which at least one party to the contract can avoid.

The main situations where voidable contracts exist are where there are formation problems related to capacity, or what this text calls other formation problems. In particular, most contracts made by parties who lack capacity because they are minors, mentally incompetent, or intoxicated are voidable by those parties. In addition, most contracts which have the formation problems of misrepresentation, duress, or undue influence, and many contracts resulting from a mistake, are voidable by the party who is the "victim" of the problem. Although these are the most common situations where contracts are voidable, there are some others. Where a contract has a formation problem with legality or formality, it may be similar to voidable, in limited situations in some jurisdictions. These situations are too complex to discuss here. But they involve an agreement with a formation problem that works to the disadvantage of one of the parties, or of which one party was not aware at the time of formation. Such formation problems will be further explained in Section 1.4 below.

There are several important legal effects of a voidable contract. Perhaps the most important one is that the party with the right to avoid need not obey the contract if he does not wish to do so. Unless that party properly indicates that he wishes to proceed with the contract, neither the other party to the contract nor a court can force him to obey it. The purpose of this rule is to protect parties who are the victims of the formation problems discussed above. The rule is also intended to deter parties from making most kinds of contracts with persons who lack capacity, and from using unfair formation practices such as duress.

Another important effect of a voidable contract is that the contract basically works like a valid contract unless the party with the right to avoid actually uses that right. That means that the party with the right to avoid the contract can enforce the contract whether the other party likes it or not. This is true even though the contract cannot be enforced against the party with the right to avoid unless he chooses to proceed with it! But if the party with the right to avoid the contract does not properly do so, then the contract is enforceable like any other contract. And of course, if the party with the right to avoid does proceed with the contract, he must perform the contract as if it was valid. That party cannot expect the other party to perform while he does not!

Where there is a voidable contract, the party with the right to avoid can disaffirm or ratify it.

*** **DEFINITION:** To **disaffirm** a voidable contract is to indicate properly that a party will avoid the contract--that he will not obey it.

*** **DEFINITION:** To **ratify** a voidable contract is to indicate properly that a party intends to be bound by the contract--that he will obey it.

After a party disaffirms a voidable contract, the contract cannot be enforced. However, the disaffirming party, and in some cases the party without the right to disaffirm, can get restitution of what has been provided to the other party, under the doctrine of quasi-contract.

After a party ratifies a voidable contract, the contract can be enforced like a valid contract. The party who had the right to disaffirm no longer has that right.

There are limits on a party's ability to disaffirm and ratify a voidable contract. The limits on ratification protect the party with the right to avoid. The limits on disaffirmance protect the other parties to such contracts. For example, the general rule in many jurisdictions is that persons who lack capacity cannot ratify until they actually have capacity. In the case of minors, this is true even if the minor actually does proceed with the contract! The minor can still change his mind later and avoid the contract, up until a reasonable time after he reaches the age of majority and gains capacity. The rules about disaffirmance and ratification cannot be fully discussed here. But they will be explained in more detail in Chapter 4 ("Capacity").

*** ***CASE STUDY 2***

FACTS Samharn, who was 17 years old, made an agreement with his neighbor Meng, who was 25 years old. The agreement said that Samharn would buy Meng's moto for $800. However, before the time for delivery, Meng sold the moto to someone else!

Samharn asked a court for help in enforcing his agreement with Meng. But Meng claimed that the agreement was not enforceable, because Samharn was a minor who did not have the capacity to make an enforceable contract. The age of majority in the jurisdiction was 18 years old.

QUESTION OF LAW Is Meng correct that Samharn cannot enforce this agreement because Samharn lacked capacity when he made it?

DECISION No. Samharn can enforce this agreement even though he was a minor because parties who lack capacity can still enforce the voidable contracts they make.

A voidable contract is enforceable, but at least one party to such a contract can avoid it. That party can also enforce the contract if he wishes. Contracts minors make are generally voidable by the minor.

In this case, Meng made an agreement to sell his moto to Samharn, a minor. Although this contract is probably voidable by Samharn, he can enforce the contract against Meng if he wishes to do so. The contract is voidable, not void. So Meng cannot avoid the contract because Samharn was a minor. Only Samharn can avoid it. And in this case, Samharn chose to enforce--not avoid--the contract. Of course, Samharn will also be required to perform his duties under the contract.

*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity"), Chapter 5 ("Legality"), Chapter 6 ("Formality"), and Chapter 7 ("Other Contract Formation Problems") contain further discussion about contract formation problems that may cause a contract to be voidable.

(3) A Void "Contract" Is Not Enforceable by Anyone

Some formation problems are so serious that agreements with those problems cannot be enforced by anyone. These agreements are void.

*** **DEFINITION:** A **void "contract"** is an agreement that is not enforceable by anyone.

Because a contract is an agreement the law will enforce, void "contracts" are not really contracts at all! So this text will generally refer to them as "agreements," rather than contracts.

The main situations where void agreements occur are where an agreement has very serious formation problems, particularly a lack of real agreement, consideration (in common law jurisdictions), or legality. (Of course, an "agreement" without real agreement may not even be an agreement!) Unconscionable agreements also appear to be void. And in many situations, agreements that fail to meet formality requirements are said to be void, though that is not always the case. Although these are probably the most important situations where void agreements occur, there are others. Some agreements with the formation problems of a lack of capacity, mistake, or misrepresentation are also void. As with voidable contracts, these situations are too complex to discuss in detail here. They will be discussed in more detail in Chapters 3-7.

The main effect of a void agreement is that it cannot be enforced by anyone. It does not matter how much the parties wanted the agreement to be binding, or what they do after the agreement is made. And no court can make the agreement enforceable.

*** ***CASE STUDY 3***

FACTS Sok and Lundy agreed that Sok would give Lundy $30, and in exchange Lundy would kill Mony. But later, Lundy refused to perform the agreement. Sok asked a court to enforce the agreement.

QUESTION OF LAW Will a court enforce the agreement between Sok and Lundy?

DECISION No. A court will not enforce this agreement because it is an agreement to commit a crime, and it is therefore void.

Void contracts cannot be enforced by anyone. Agreements that fail to meet the requirement of legality are generally void. And agreements to commit crimes can never be enforced.

In this case, Sok and Lundy agreed that Sok would pay Lundy money to kill Mony. This is an agreement to commit the crime of murder. Therefore, the agreement fails to meet the requirement of legality. It is void, and it cannot be enforced by anyone. So Sok cannot enforce it.

In certain special cases, contracts may be only partly void. In these unusual situations, part of the contract is unenforceable, but the remainder of the contract can be enforced. This may occur where a court is able to "sever" the void part of the contract, and fairly and effectively enforce what remains. Of course, this is often impossible. Important examples of situations where it might occur are where a court enforces a usurious loan agreement at the legal rate (severing the illegal part), and where a court enforces an agreement without an unconscionable part.

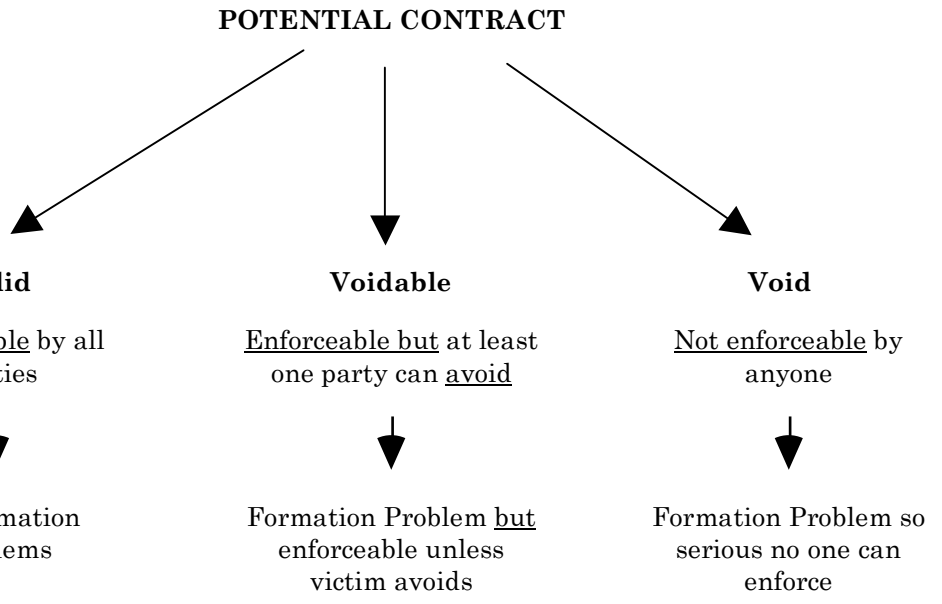
*** ***ADDITIONAL REFERENCE:*** Chapters 2-7 contain further discussion about contract formation problems that may cause an agreement to be void; Chapter 5 ("Legality"), Sections 5.3c, 5.4f, 5.4g, and 5.5b, Chapter 7 ("Other Contract Formation Problems"), Sections 7.3b, 7.3c, and 7.7c, and Chapter 10 ("Remedies"), Section 10.7c contain further discussion of severance.

(4) Summary of Classification of Contracts by Enforceability

The following chart illustrates the three basic ways courts classify contracts by enforceability.



Illustration: Ways Courts Classify Contracts by Enforceability



*** ***WHY IS THIS IMPORTANT?*** Why do courts classify contracts as valid, voidable, or void?

As noted above, one of the most basic goals of contract law is to promote the enforcement of contracts. However, the law does not believe that agreements should be enforced in every situation! In fact, another basic element of contract law is that sometimes agreements should not be enforced. The law makes this distinction in order to promote justice and efficiency. The law believes that some agreements are helpful to society and should be enforced (those without formation problems), while others are less helpful and should be enforced only in certain cases or not at all (those with formation problems). The problem for contract law is to devise fair and efficient rules to help people know the difference. To help solve this problem, legal authorities devised the classifications of valid, voidable, and void. These provide a general basis for courts and parties to know when agreements will be enforced.

A valid contract occurs where the law believes the contract has no formation problems, so it should be enforceable by all parties to it. A contract to trade legal goods for money, with no formation problems, is an example of a valid contract.

Voidable contracts occur where the law believes the contract has a formation problem, but that it should still be enforceable unless the party who is basically the subject or "victim" of that problem wishes to avoid it. Voidable contracts are an example of how the law tries to balance competing goals: the general policy of promoting the enforcement of contracts vs. basic fairness to the party who is the victim of a formation problem. The law promotes enforcement by giving the victim the option to proceed with the contract. But this same option also promotes fairness, allowing the victim to avoid

the contract if he wishes. A contract made under duress is an example of a contract with this kind of formation problem.

Finally, void agreements occur where the law believes an agreement has a formation problem so serious that the agreement should not be enforced at all, despite the general policy in favor of enforcing contracts. A contract to commit an illegal act is an example of a contract the law believes has such a serious formation problem that it should not be enforceable by anyone. In that situation, the goal of not promoting or assisting illegal acts outweighs the goal of promoting the enforcement of contracts.

1.3b Contracts Classified by Their Basic Nature: Bilateral and Unilateral Contracts

Another important way contracts are classified is by their basic nature. In common law jurisdictions, this classification refers to whether the contract is bilateral (an exchange of promises) or unilateral (an exchange of a promise for an act).

In civil law jurisdictions, the terms "bilateral contract" and "unilateral contract" may have different meanings. For example, in France, it appears that a bilateral contract is one with obligations on both sides, whereas a unilateral contract is one with obligations on only one side, as would occur with an agreement to make a gift. Of course, that kind of unilateral agreement might not be enforceable at all in common law jurisdictions, because of a lack of consideration.

(1) In Common Law Jurisdictions, a Bilateral Contract Is Basically an Exchange of a Promise for a Promise

In most contracts, the parties basically exchange promises. In other words, each party promises to do something the other party wants, and this is the real basis for the contract. In common law jurisdictions, these are called bilateral contracts.

*** **DEFINITION:** Under common law, a **bilateral contract** is a contract in which the parties exchange promises to do things.

The English word "bilateral" means "two-sided." In common law contract law, bilateral means that there are promises on two sides of the contract--on the side of each party. That means each party is making at least one promise (often many promises) to do something. So the basic nature of a bilateral contract is a promise for a promise. A contract may have more than two parties, but for ease of discussion, this text will discuss two-party contracts. The same basic rules apply to contracts with more parties.

For example, suppose Sorith and Sathya agree that Sathya will pay 1,800 riels, and in exchange Sorith will provide Sathya with one kilo of

black-eyed peas. This is a bilateral contract, because it is an exchange of promises: Sathya's promise to pay money, and Sorith's promise to provide black-eyed peas.

Many contracts, including most large commercial contracts, are bilateral. Bilateral contracts are often more useful than unilateral ones, which consist of an exchange of a promise for an act. This is because bilateral contracts generally provide more security to both parties. In a bilateral contract, each party receives an enforceable promise that what he wants to happen will actually happen. In the beans example above, that means that Sorith can enforce in court Sathya's promise to pay, and Sathya can enforce in court Sorith's promise to provide black-eyed peas. This provides security for both parties. By contrast, in a unilateral contract situation, only one side receives a promise.

*** ***CASE STUDY 4***

FACTS Bunna is tired. He wants to sit down. So he makes a contract with Socheat. In the contract, Socheat promises to build Bunna a chair. In exchange, Bunna promises to pay Socheat 10,000 riels.

QUESTION OF LAW Do Socheat and Bunna have a bilateral contract?

DECISION Yes. Socheat and Bunna have a bilateral contract because they have exchanged a promise for a promise.

In common law jurisdictions, a bilateral contract is an exchange of a promise for a promise. In this case, Bunna and Socheat made a contract in which Bunna promised to pay 10,000 riels, and Socheat promised to build a chair. In other words, the parties exchanged promises. Therefore, this is a bilateral contract. So both parties must perform the promises they made.

(2) In Common Law Jurisdictions, a Unilateral Contract Is Basically an Exchange of a Promise for an Act

In common law jurisdictions, the parties can form a contract by exchanging a promise for an act. In other words, one party makes a promise, and the other party performs an act. Common law jurisdictions call these unilateral contracts. As explained in Section 1.3b above, the meaning of this term differs in civil law jurisdictions like France.

*** **DEFINITION:** Under common law, a **unilateral contract** is a contract in which the parties exchange a promise for an act.

The English word "unilateral" means "one-sided." In common law contract law, unilateral means that there is a promise on only one side of the contract. That means only one party is making a promise to do something.

The other party is not making a promise. Instead, he performs an act. So the basic nature of a unilateral contract is a promise for an act.

Unilateral contracts generally occur where one party makes an offer in which he promises to do something if another party performs some act. So instead of requesting a return promise--as in a bilateral contract--this kind of offer requests only an act. The party who receives such an offer can choose to accept the offer, by performing the act requested. Or the other party can choose not to accept the offer, not perform the act, and there is no contract. In that situation, there is nothing to enforce against the party who received the offer. Even if he starts to perform the requested act and then stops, there is nothing to enforce against him. This is because he has made no promise. In any case, the offer generally contains the promise (or promises), and the acceptance generally is the act.

For instance, in the beans example above, suppose the parties make their contract a little differently. Suppose Sathya says: "Sorith, if you provide me with one kilo of black-eyed peas, I will pay you 1,800 riels." Then Sorith provides her with the black-eyed peas. In this situation, the parties made a unilateral contract. Sathya made a promise: the promise to pay Sorith if he provided black-eyed peas. But Sorith made no promise. It was only when he provided the black-eyed peas--an act--that he formed a contract. At that point, Sathya was obligated to pay him. But Sorith had no duty to provide the black-eyed peas, because he made no promise. He could have simply walked away, and Sathya would have had nothing to enforce against him. And of course, in that case, Sathya would have had no duty to pay either. There would have been no contract at all.

So there are a few key differences between bilateral and unilateral contracts in common law jurisdictions. The most obvious one is that in unilateral contracts, only one party makes a promise. Typically, one party makes an offer that requests an act. The other party chooses whether to accept--by performing the act requested--or not accept. The other party has no duty to perform the requested act. And the party requesting the act generally has no duty unless the act is performed.

Another important difference is that unilateral contracts are generally considered to be less common than bilateral ones are. This is because unilateral contracts generally provide less security to parties. Most parties want some assurance that the acts they want performed really will be performed--such as an enforceable promise saying they will--or that otherwise a court will provide a remedy. Of course, unilateral contracts cannot give both parties that assurance. That is because the party making the promise has no assurance that anyone will perform the act he has requested! These events will be discussed in more detail in Section 1.4a of this Chapter, and in Chapter 2 ("Real Agreement (Offer and Acceptance)").

Unilateral contracts may be less common than bilateral contracts, but they do occur in certain situations where they meet the special needs of the parties. These are generally situations where the parties actually do not want, or know they cannot get, an enforceable promise that someone will perform the acts they request. Situations where unilateral contracts do occur include public offers (such as reward offers), client-broker arrangements, and some loan contracts.

******* ***CASE STUDY 5***

FACTS Vandy lost her car. In order to get it back, she made a public offer in several local newspapers. The offer described the lost car and said that Vandy would pay $500 to anyone who actually found and returned the car.

Dara saw this offer. He looked for the car, and after some time he found it. He returned the car to Vandy and requested the $500. Vandy thanked Dara, but laughed and said she had never seen him before, so she could not possibly owe him any money.

QUESTION OF LAW Does a unilateral contract exist between Vandy and Dara?

DECISION Yes. This is a unilateral contract because Dara actually performed the act Vandy requested in her offer, so Vandy must pay Dara the $500 as she promised.

In common law jurisdictions, a unilateral contract exists where the parties exchange a promise for an act. Specifically, it occurs where one party makes an offer requesting a specific act, and another party actually performs that act.

In this case, Vandy made a public offer in which she promised to pay $500 to anyone who found and returned her lost car. Vandy's offer requested that anyone who saw the offer perform a specific act--find and return her car--and promised to pay $500 to the person who actually performed that act. Dara saw the offer, then found and returned the car. When Dara did that, he formed a unilateral contract with Vandy--he exchanged his act for her promise, as she had requested. That unilateral contract requires Vandy to perform her promise: to pay Dara $500. Of course, Dara could have chosen not to perform the act. In fact, no one had any obligation to do so. And if no one had done so, no contract would have been formed. But Dara did perform the act. So Vandy must pay him according to her promise.

An important effect of a unilateral contract is that, as soon as it is formed, the performance of one party is basically over. This is because the party who forms the contract by performing the act requested also ends his main obligation under the contract by performing that act! The party may still

have certain duties that many jurisdictions say exist in all contracts, such as the duty of good faith and fair dealing. But basically, that party is finished performing under the contract. So it is the other party--the one who made the promise--who still has his main duties to perform. If he fails to do so, then the party who performed the act requested in the offer can ask a court for a remedy. So unilateral contracts are much more likely to be enforced against the party who made the promise. In that way, the obligations under a common law unilateral contract are also "one-sided" (somewhat like the civil law idea of a unilateral contract which was described above). This is because, as soon as the contract exists, only one party still must perform his main obligation.

*** ***WHY IS THIS IMPORTANT?*** Why do common law jurisdictions put contracts into the bilateral and unilateral categories described above, based on their basic nature?

Common law jurisdictions make this distinction for several reasons. Two important ones relate to real agreement (offer and acceptance). Specifically, whether a contract is bilateral or unilateral affects how the offeror can terminate an offer, and how the offeree can properly accept the offer.

With regard to termination of offers, many common law jurisdictions say that offerors can generally revoke offers any time before acceptance. But with unilateral contract offers, problems can occur where a party starts to perform the act requested, but the offeror tries to revoke the offer. If the offeror was permitted to revoke in that situation, it could cause great unfairness. So the law limits the ability of offerors to revoke in that situation. The specific rules about this will be discussed in detail in Chapter 2 ("Real Agreement (Offer and Acceptance)").

The distinction between bilateral and unilateral contracts is also important because it affects how an offeree can properly accept the offer. Obviously, it is crucial that the offeree know how to accept an offer properly. This distinction provides a way for the offeree to know how to do that. In general, offers for bilateral contracts are accepted when parties properly make the promise requested. Offers for unilateral contracts are accepted when parties properly perform the act requested. This is a big difference. Once again, these rules about acceptance will be explained in detail in Chapter 2.

Finally, this distinction affects the ability of parties to get a remedy for the other party's failure to perform the contract. This is because, as explained above, at the time a unilateral contract is formed, one party has basically performed his main duties under the contract. So there is not much left to enforce against that party, except certain duties that some jurisdictions imply in all contracts. But the other party has not yet performed his main duties under the unilateral contract. So the contract is much more likely to be enforced against that party. By contrast, with bilateral contracts, at the time

of formation, the duties of both parties remain to be performed. So either party may ask a court for a remedy if the other party fails to perform.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Sections 2.4d and 2.9-2.11 contain further discussion about the differences between bilateral and unilateral contracts; Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and Chapter 9 ("Performance and Discharge of Duties"), Sections 9.4h and 9.5c, discuss duties some jurisdictions imply in all contracts; Chapter 10 ("Remedies") discusses remedies.

1.3c Contracts Classified by Their Stage of Performance: Executed and Executory Contracts

Another important way the law classifies contracts is by their stage of performance. The law basically divides contracts into two categories in this respect: executed contracts (those which have been fully performed by all parties), and executory contracts (those which have not yet been fully performed by all parties).

(1) An Executory Contract Is One That Has Not Been Fully Performed by All Parties

There is always some time between when a contract is formed and when it has been fully performed by all parties. During this time, the contract is executory.

*** **DEFINITION:** An **executory contract** is one that has not yet been fully performed by all parties.

All contracts are executory for some time, whether for only a few seconds or many years.

For example, suppose Thanna makes a contract with Sambo in which Thanna agrees to work for Sambo for six months, at a salary of $1,000 per month. This contract is executory until both parties have fully performed their duties under the contract. So the contract will be executory for at least six months, since Thanna could not possibly finish his duties until that time. And this is true even if Sambo pays Thanna his full salary of $6,000 right after the contract is made. A contract is executory until all duties under the contract have been completely performed.

(2) An Executed Contract Is One That Has Been Fully Performed by All Parties

After some time, most contracts are fully performed by the parties, since that is the main goal of parties who make contracts. When contracts have been fully performed by all parties, they are executed.

*** **DEFINITION:** An **executed contract** is one that has been fully performed by all parties to the contract.

In the example above, where Thanna agreed to work for Sambo for six months for $1,000 per month, the contract would be executed only when both Thanna and Sambo had fully performed all their duties. So in order for this to occur, Thanna would have to have done all of the work the contract required, and Sambo would have had to pay Thanna completely as the contract required. If anything at all remained to be done--even if it was only that Sambo had paid $5,900 instead of $6,000--then the contract would not be executed. It would be only executory.

*** ***CASE STUDY 6***

FACTS Bora offered to sell Phally a fishing boat for $2,000. The offer said that delivery was to occur one day after the contract was formed, and that payment was to occur two days after the contract was formed. Phally accepted the offer, and the next day Bora delivered the boat.

QUESTION OF LAW Is this contract executed?

DECISION No. The contract is not executed because Bora and Phally have not fully performed all of the duties under the contract.

Contracts are executed only when all parties to the contract have performed completely their duties under the contract. In this case, Bora agreed to sell his boat to Phally. Bora delivered the boat to Phally, so his duties under the contract are basically finished. However, Phally's duties are not yet finished, because he has not paid $2,000 as the contract requires. So this contract is not executed. It will be executory until all parties have completely performed their duties.

*** ***WHY IS THIS IMPORTANT?*** Why do many jurisdictions measure the stage of performance of contracts, and make the distinction between executory and executed contracts?

This distinction is important for several reasons. At the most basic level, it helps courts and parties know whether a contract has been fully performed or not. More importantly, it helps courts make decisions about how they will respond to a number of problems in the formation and performance of contracts. Several of these problems are discussed below.

Sometimes the law treats contract formation problems differently depending on whether the contract has been executed. For example, where a contract is voidable because one party was a minor, many jurisdictions say that different things happen to the contract when that minor reaches majority based on whether the contract is executed. Specifically, if a minor is silent about an executory contract for a reasonable time after he reaches majority,

then the effect is to disaffirm that contract. But if the minor is silent about an executed contract for a reasonable time after he reaches majority, the effect is to ratify that contract. This will be discussed in more detail in Chapter 4 ("Capacity").

In addition, many jurisdictions treat formality problems differently depending on whether the contract is executed. Specifically, many jurisdictions say that if a contract is executed, it is no longer subject to attack on the basis that it fails to meet a writing requirement. Of course, if a contract has been executed, there is not usually a need to enforce it. But the practical effect would seem to be that, after a contract is fully performed, no party can use the lack of a writing as a basis to demand a remedy such as restitution. This will be discussed further in Chapter 6 ("Formality").

The stage of performance of a contract can also affect the remedies that a court may order or allow in other situations. For example, where a contract is executed, or where a contract is completely performed on one side, the remedy of rescission (canceling the contract) may not be available. Many common law jurisdictions say that parties generally cannot mutually rescind a contract where the contract has already been fully performed on one side. This is because there would generally be no consideration for the agreement to cancel from the party who had not yet performed. That party would not be agreeing to any new legal detriment by canceling a contract under which he had already received full performance! In addition, if the contract was executed, mutual rescission would not seem possible, because there would really be nothing left to cancel. This issue might arise where there was some formation problem such as mistake, and the party who was the victim of the problem wanted to avoid the contract after it had been partly or fully performed. Of course, other remedies such as money damages might still be available. These issues will be further discussed in Chapter 9 ("Performance and Discharge of Duties") and Chapter 10 ("Remedies").

*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity"), Section 4.4 contains further discussion of the effect of stage of performance on contracts minors make; Chapter 6 ("Formality"), Section 6.3 contains further discussion of the effect of stage of performance on contracts that fail to meet writing requirements; and Chapter 9 ("Performance and Discharge of Duties"), Section 9.7a, and Chapter 10 ("Remedies"), Section 10.7b, contain further discussion of rescission.

1.3d Contracts Classified by Their Form

The law has a number of different ways to classify contracts based on their physical form. In particular, the law classifies contracts based on whether they are: express (in words) or implied (from conduct); made in written or oral words; and formal (under seal) or simple (not under seal). These categories can have important effects on the formation, performance and enforcement of contracts.

(1) Contracts May Be Express (in Words) or Implied (from Conduct)

Contracts made in words are called express contracts, while contracts implied from conduct are called implied contracts. First express contracts will be discussed.

*** **DEFINITION:** An **express contract** is one made in words.

Express contracts may be oral or written. The important thing is that the parties have used words to make their contract.

*** ***CASE STUDY 7***

FACTS Sophoan wrote a note to Chhay which said: "I offer to sell you three standard pieces of tofu for 2,000 riels, with delivery to occur in two days at your house, and payment to be made half at the time the contract is made, and half at the time of delivery." In reply, Chhay wrote a note to Sophoan which said: "I accept your offer."

QUESTION OF LAW Is this contract express?

DECISION Yes. This contract is express because Sophoan and Chhay put their agreement in words.

Express contracts are contracts made in words. In this case, Sophoan and Chhay agreed in words that Sophoan would sell Chhay three pieces of tofu for a certain price, along with specific terms of delivery and payment. Because the parties made this contract in words, it is an express contract.

When contracts are not made in words, but instead are made through the conduct of the parties, they are called implied contracts. Implied contracts are generally enforceable, just like express contracts.

*** **DEFINITION:** An **implied contract** is one made through the conduct of the parties.

In implied contracts, parties make their contract through their actions. Of course, words are a kind of action, so it might be more precise to say that parties make implied contracts through non-verbal conduct. The conduct from which an implied contract is implied can also include the circumstances surrounding the actions of the parties. For example, courts can sometimes imply a reasonable price from the circumstances surrounding an agreement.

In order for the parties to make a contract without words, it must be clear that their conduct really shows all the elements needed for a contract to exist. That means all the requirements discussed in Section 1.2 above, including the requirement of real agreement. It is not necessary to determine exactly which party made the "offer" and which one made the "acceptance"

in order for a contract to exist. It is only necessary that, even though the parties are not using words, they must somehow show clearly and definitely enough that they really agree, and what it is that they agree. Whether the parties have done that can be hard to determine.

In order to determine whether the parties have really shown an enforceable agreement through their conduct, many jurisdictions use an objective, reasonable person standard. That means they ask whether a reasonable person in the same circumstances, using the judgment and experiences of an ordinary person, would think that the conduct of the parties showed such an agreement. This "reasonable person" standard is a very important one in law. It was already discussed briefly in Section 1.2 above, in the explanation of the objective and subjective methods many courts use to interpret contracts. An objective analysis focuses on what a reasonable person would likely have done or intended in the same situation. A subjective analysis focuses on what the parties involved in a particular transaction or situation really did or intended. In any case, courts use the objective standard to help them resolve a variety of difficult problems in contract law, and in many other fields of law.

For example, suppose Keary rides her moto into a moto parking lot, and Chantha, the lot attendant, gives Keary a ticket to show which moto is hers. Keary leaves her moto in the parking lot. In this situation, even though the parties have not used any words, they probably have a contract. This is because a reasonable person would probably say their conduct has shown that they have one. It shows that they have agreed that Chantha will allow Keary to park in the parking lot, and that Keary will pay Chantha for this. Of course, the parties have not made certain terms of the contract--such as the price--completely clear. But in this situation a court would probably imply a reasonable price, based on the circumstances surrounding the parties' agreement, such as any past dealings between the parties and the current market price for this kind of parking. This will be discussed further in later Chapters.

However, suppose Keary put her moto near--but not inside--Chantha's parking lot, then walked away without getting a ticket. In that situation, it is unlikely that the parties have a contract. This is because a reasonable person would probably not say that their conduct has shown one. Keary did not put her moto in Chantha's lot. And Chantha did not give Keary a ticket. The parties have not shown clearly that they want to have a contract together.

******* ***CASE STUDY 8***

FACTS Kosal decided to ride a ferry across the river to get to work one morning. He boarded the ferry on one side of the river and rode across. Before the ferry reached the other side, Kosal paid for the ride along with all the other passengers. During all this activity, Kosal did not speak with the operator of the ferry.

QUESTION OF LAW Is there a contract between Kosal and the ferry operator?

DECISION Yes. An implied contract exists between Kosal and the ferry operator because their conduct has clearly shown that contract.

Implied contracts are those made through conduct (not words) of the parties. They exist where a reasonable person would say that the parties' conduct shows they made a contract together.

In this case, Kosal boarded a ferry and rode across a river with a number of other passengers. Before the ferry reached the other side of the river, Kosal paid the ferry operator for the ride, as the other passengers did. Kosal and the ferry operator did not communicate with each other through words. However, in this situation, Kosal and the ferry operator have an implied contract, because their conduct has shown it. Kosal boarded the ferry and began to ride across the river. The ferry operator began to take Kosal across the river. These actions created the contract. A reasonable person would probably say that Kosal expected to be taken across the river, and the ferry operator expected Kosal to pay him. Of course, the parties did not specify a price. But a court would likely imply a reasonable price, which would probably be the one everyone else was paying.

Many contracts are actually partly express and partly implied. That is, many contracts are to some extent made in words, but also to some extent implied from conduct, including the circumstances surrounding the parties' actions. This generally occurs where the parties use words for some important terms, but do not specify other terms in words. Often, the law will imply these terms, as long as that can be done in a way that is consistent with what the parties appeared to want in their contract. In fact, it might be argued that few contracts are completely express. This is because few contracts actually state in words all the terms that the law will imply, such as the duty of good faith and fair dealing, and certain warranties that many jurisdictions say exist in many kinds of contracts. On the other hand, certain essential terms cannot be implied if the parties did not specify them. This is discussed further in future Chapters, especially Chapter 2 ("Real Agreement (Offer and Acceptance)") and Chapter 8 ("Interpretation of Contracts").

*** ***CASE STUDY 9***

FACTS Samneang made a written offer to sell Vantha a radio for $100. Vantha wrote back saying that she accepted the offer.

QUESTION OF LAW Is this contract partly express and partly implied?

DECISION Yes. The contract Samneang and Vantha made is partly express, because the parties used words for some terms, but also partly

implied, because they did not use words for other terms, and these will be implied based on the circumstances.

In many cases, contracts are partly express and partly implied. That happens where the parties use words for some of the terms in their contract, but other terms are implied based on conduct, including the surrounding circumstances.

In this case, Samneang and Vantha agreed in words that Vantha would buy Samneang's radio for $100. This means the contract is at least partly express. However, although the parties used words to make their contract, they did not specify certain important aspects of the agreement. For example, they did not say when or where delivery of the radio was to occur, or when or where payment would occur. Many jurisdictions will imply these terms even though the parties did not state them, based on the circumstances surrounding the parties' agreement. Such jurisdictions would probably say that delivery should occur within a reasonable time at Samneang's place of business (or residence), and payment should occur at the time and place of delivery. Of course, if the parties had stated these terms, the terms the parties stated would generally be enforced.

*** ***WHY IS THIS IMPORTANT?*** Why do courts enforce both express and implied contracts?

Courts enforce both express and implied contracts because the law wants to support and encourage real agreements, whether the parties use words to make them or not. In many cases, it would not be practical or convenient for the parties to put their contracts in words. Examples include the ferry and moto parking lot situations described above. In cases like these, it would slow the parties down--and burden commercial activity--if the law required the parties to make their contracts in words. If the ferry operator had to stop and speak to one hundred different passengers, it would take a lot more time than if the passengers simply got on the boat. In these situations, it is generally better for people to use more efficient ways to make their agreements--through conduct. The law wants to support such agreements, which fulfill the reasonable expectations of the parties. So it will enforce these agreements.

It would also burden economic activity if the parties had to put every term in their contracts in words. So the law also enforces contracts that are partly express and partly implied, supplying some terms the parties did not actually specify, if it is reasonable to do so under the circumstances. Of course, not all missing terms can be implied.

In addition, the conduct of the parties must be clear enough that the courts can enforce the contract. In many situations, the parties cannot practically make their contracts unless they use words. This is especially true about agreements that are more complex than the ones above, as many

business contracts are. In these cases, parties should use clear words to describe their agreements as completely as is practical. Otherwise, the agreements may not be clear enough for the parties to perform or the courts to enforce.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Sections 2.3b and 2.10 contain further discussion about express and implied contracts, and about terms courts may imply in contracts; Chapter 8 ("Interpretation of Contracts"), Section 8.3j contains further discussion of terms courts may imply in contracts.

(2) Express Contracts May Be Written or Oral

When contracts are express, they may be made with written words or spoken words. Contracts made in these ways are called written contracts and oral contracts.

*** **DEFINITION:** An **oral contract** is one made using spoken words.

*** **DEFINITION:** A **written contract** is one made using written words.

In general, both oral and written contracts are enforceable. This is because one of the most important goals of contract law is to enforce genuine agreements of the parties, unless there is some good reason not to do so. Parties can make genuine agreements orally. So oral contracts are generally just as enforceable as written contracts, as long as they meet all the requirements for enforceability which are discussed in this Chapter. This is true even though oral contracts may seem less formal and may be harder to prove in court, and even though the law requires certain contracts to be written to be enforceable. In fact, in some situations, oral contracts may be better than written ones! This is because they may be more practical for smaller transactions that happen every day.

For example, suppose Samy took a cyclo to the market to buy some tomatoes. She is likely to make an oral contract with the cyclo driver, and an oral contract to purchase the tomatoes from a market seller. These are valid contracts. And they are probably better than written contracts would be in these situations. This is because it would probably not be practical or efficient for these parties to take the time and effort needed to make a written contract about relatively small transactions like these. And another important goal of the law is to promote an efficient economy.

However, in certain situations, the law does generally require that agreements be written in order to be enforceable. In particular, many jurisdictions require writings for agreements for the transfer of substantial interests in land; agreements for the sale of goods over a certain

monetary amount; suretyship agreements; agreements that cannot be performed within one year; and agreements in which one party promises to do something in exchange for the other party's marriage or promise to marry. These rules require parties to put such important agreements in writing if they want to enforce them. That encourages the parties to think carefully about such agreements, and to be more clear and complete in expressing them. It also helps provide better evidence for courts to enforce the agreements. This is discussed further in Section 1.4e below, and in Chapter 6 ("Formality").

In addition, even if the law does not require a contract to be written, parties should put all important contracts in writing. This is because, in many situations, written contracts are much better than oral ones. Written contracts generally provide better proof that a contract actually exists. And as noted above, they often provide a way for the parties to express their agreement more clearly and completely than an oral contract can. This protects the parties, because it makes it easier for both parties and courts to know what the parties agreed. And it can reduce the number of disputes that may occur about the contract. Written contracts are an especially good idea where the parties do not know each other well, or where performance is to occur over a long period of time (during which parties might forget the terms of an oral contract).

******* ***CASE STUDY 10***

FACTS Sophea and Bun Leng agreed orally that Sophea would do carpentry work for Bun Leng for six months for $200 per month. Sophea worked for about three months, and Bun Leng paid him at the end of each month.

But during the fourth month, Bun Leng asked Sophea to stop. Sophea said that the parties' agreement lasted for six months. But Bun Leng said: "What agreement? Show me the agreement!" Sophea asked the court for help.

QUESTION OF LAW Do Sophea and Bun Leng have an enforceable contract for six months?

DECISION Yes. Sophea and Bun Leng have an enforceable oral agreement for six months of carpentry work, but Sophea will have to provide evidence that persuades the court about the existence and terms of the agreement.

Oral contracts are generally enforceable as long as there is no specific legal requirement that they be written. However, written contracts are often better than oral ones for important agreements, because written contracts provide better proof about the existence and terms of the agreement.

In this case, Sophea and Bun Leng agreed orally that Sophea would work for Bun Leng for six months. But in the fourth month, Bun Leng

told Sophea to stop work, and denied the existence of the agreement. Despite Bun Leng's claim, Sophea has an enforceable agreement.

However, that alone does not solve Sophea's problem! That is because, in order to enforce the contract, Sophea must persuade the court about its existence and terms. In this case, it appears that Sophea has no written evidence of the contract. He can still use oral evidence, including his own testimony and other relevant evidence, to prove the contract exists. But Bun Leng will probably deny that it exists. Because the court does not know what really happened--the court was not present when Sophea and Bun Leng made their contract--it may have difficulty deciding whether there is a contract as Sophea claims. It may be Sophea's testimony against Bun Leng's testimony. The result will depend not on who is correct, but on who the court believes is correct. Sophea may convince the court that he is correct--or he may not.

That is why parties like Sophea should put important contracts like this in writing, even when the law does not require it. A writing generally provides better evidence about the existence and terms of a contract. It would give Sophea a better chance of persuading the court to enforce the contract.

Problems may occur where a contract appears to be partly written and partly oral. In these situations, it can be very difficult to know what the contract terms really are! And parties may not be able to enforce certain terms they think are in their agreements if those terms are not in the writing they create. For example, common law jurisdictions that apply the parol evidence rule generally do not allow evidence of prior statements to contradict a final contract writing, or to contradict or add terms to a final and complete contract writing. This rule encourages parties to put all important terms in the writings they make to record their contracts. So where parties use a writing, it is generally crucial for them to put all the key terms in the writing. This will be further discussed in Section 1.4g, and in Chapter 8 ("Interpretation of Contracts").

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality") discusses writing requirements more fully; and Chapter 8 ("Interpretation of Contracts") explains how many courts handle the problem of contracts that appear to be partly written and partly oral.

(3) Formal Contracts Are Those Made under Seal, While Simple Contracts Are Those Not Made under Seal

Certain written contracts are made with a seal. In some jurisdictions, these are called formal contracts. All other contracts--whether written contracts with no seal, oral contracts, or implied contracts--are called simple contracts.

*** **DEFINITION:** A **formal contract** is one made under seal.

*** **DEFINITION:** A **simple contract** is one not made under seal.

It appears that the use of seals in contracts originally developed in some jurisdictions as a kind of signature because few people could write. Today, seals may still be used in some cases in addition to a signature.

Traditionally, seals had several effects on contracts. First, it appears that in many common law jurisdictions a seal could actually substitute for consideration in a contract. In other words, a formal contract would not require consideration in order to be enforceable. So if Sochua and Chhien agreed in a formal contract that Chhien would pay Sochua 1,000 riels, but Sochua did not do or agree to do anything in exchange, Chhien's promise would be enforceable--even though there was no consideration for it!

In addition, it seems that in some common law jurisdictions formal contracts were subject to longer statutes of limitation than simple ones. A statute of limitations says how much time a party has to make a certain kind of legal claim in court after the claim arises. For instance, in the example above with Sochua and Chhien, suppose the normal statute of limitations for a breach of contract lawsuit was four years. If the contract was made under seal--as theirs was--the time specified in that statute might be longer. If it was seven years, then Sochua and Chhien would have seven years to complain to the court about a breach.

However, it appears that many jurisdictions no longer treat formal contracts differently from simple contracts. Where that is the case, such contracts are subject to the same rules about consideration and statutes of limitations as other contracts are. For example, the Uniform Commercial Code in the United States basically says that contracts for the sale of goods made under seal will be treated the same way as simple contracts are.

One basic reason that some jurisdictions have treated formal contracts differently from simple ones appears to be to provide a way for parties to give their promises more power than they would otherwise have. The distinction may allow parties to avoid the usual common law requirement of consideration for their promises, and give parties more time to bring a legal action to enforce the promises. Presumably this would give parties more flexibility to achieve their goals than they would have under the regular rules.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.8c contains further discussion of formal contracts and the common law requirement of consideration, and Section 3.8d contains further discussion of statutes of limitation.

1.4 Expanded Summary of the General Principles of Contract Law Explained in Chapters 2-11

Section 1.4 contains an expanded summary of the general principles of contract law discussed in Chapters 2-11 of this book. These principles govern whether contracts are enforceable, how courts interpret their meaning, how courts analyze contract performance, what contract remedies courts may order or allow, and third party rights and duties. These ideas were summarized even more briefly in the concise summary in Section 1.2 above. But these are difficult principles. So even this longer summary can only discuss some of the more important ideas and give a few examples. For a deeper understanding, readers should consult Chapters 2-11.

Often, courts face the basic problem of whether a contract is enforceable. In particular, in many jurisdictions, the enforceability of contracts is affected by legal requirements in the following six basic areas:

(1) real agreement (offer and acceptance) (Section 1.4a);

(2) consideration (common law jurisdictions only) (Section 1.4b);

(3) capacity (Section 1.4c);

(4) legality (Section 1.4d);

(5) formality (Section 1.4e); and

(6) other formation problems (Section 1.4f).

Of course, courts often must decide issues other than whether a contract is enforceable. They must also resolve important problems related to:

(7) interpretation of contracts (Section 1.4g);

(8) performance and discharge of duties (Section 1.4h);

(9) remedies (Section 1.4i); and

(10) third party rights and duties (Section 1.4j).

These ten important areas of contract law will be discussed below.

1.4a To Be Valid, a Contract Must Have Real Agreement (Offer and Acceptance)

Perhaps the most basic requirement for a contract to be enforceable is that the parties make a real agreement that they intend to be enforceable by law. Of course, as discussed in Section 1.3d above, a real agreement can have many different forms, such as implied or express, oral or written. But although many forms are possible, not all "agreements" meet this requirement. To analyze whether a real agreement exists, many jurisdictions generally require a valid offer and a proper acceptance between the parties to the contract. The rest of this Section will discuss offers and acceptances.

When analyzing potential contracts, it may not always be possible to identify a distinct "offer" and "acceptance." This is especially true with implied contracts, and in cases where the parties negotiate back and forth for some time. In these situations, it may be hard to say: "this was the offer, and that was the acceptance." But the important thing for real agreement to exist is that all the required elements of a valid offer and proper acceptance exist in the conduct and words of the parties.

Offer

The first thing the law requires for a real agreement is a valid offer.

*** **DEFINITION:** An **offer** is a proposal to make a contract.

The party who makes an offer is called an offeror. The party to whom the offer is made is called an offeree. For example, if Sokna says to Vuth, "I will pay you 1,000 riels if you wash these clothes," that is an offer. Sokna is the offeror, and Vuth is the offeree.

Only valid offers that meet the relevant general legal requirements can result in contracts. Specifically, in many jurisdictions, a valid offer must be:

(1) seriously intended to create legal obligations;

(2) definite and reasonably clear; AND

(3) communicated to the offeree.

First, the offer must be seriously intended to create legal obligations between the offeror and offeree, based on an objective, reasonable person standard. For example, if Sophy offers to meet Molika at a restaurant for breakfast--a social engagement--there is probably no serious offer. In addition, if an offeror makes an offer in great fear or anger or as a joke, and the offeree has a reason to know that, the offer is not seriously intended.

Second, an offer must be definite and reasonably clear. This basically means that the offer must include the essential terms of the proposed contract, and that the material (important) terms the parties include must be reasonably clear. What is required depends on what kind of contract is involved and the other circumstances. For example, many jurisdictions generally require sale of goods contracts to include at least the identity and quantity of the goods. So if Sophy said to Molika, "I offer to sell you my new blue bicycle," that offer could meet this requirement. But if Sophy merely offered to sell "a bicycle," and there was no way to determine which one--the identity--the offer might not be valid. Courts can actually imply some terms that the parties omitted, generally terms that are reasonable based on the circumstances. Many jurisdictions will supply terms to a sale of goods contract, as long as the parties have included the essential ones.

Third, the offer must be communicated to the offeree. This shows that the offeror really wanted to make a contract with the offeree. For example, if Sophy writes an offer to sell her bicycle to Molika but never communicates it to Molika, Molika cannot accept that offer, even if she learns about it some other way.

It is important to note what are generally not valid offers. In particular, preliminary negotiations and invitations to negotiate are generally not valid offers. So an indication that a party plans to make a contract, or might want to make a contract, is not a valid offer. Likewise, most marketing activities are not offers, because they are usually just general invitations to the public to negotiate. For example, if Sophy paints and displays a sign saying "Bicycle for Sale Only $50," that is probably not an offer. It is merely an invitation for the public to negotiate with her. In addition, a solicitation of bids is not an offer. So if a government solicits bids for companies to build a new hospital, the government is not making an offer--it is asking companies to make offers to it!

Offers end and are no longer valid in several situations. These are when:

(1) the offeror revokes the offer;

(2) the offeree makes a rejection or counter-offer; or

(3) a specific event or circumstance ends the offer.

An offer ends if the offeror revokes it. A revocation is the offeror's withdrawal of the offer. A revocation can occur if it is communicated to the offeree before the offeree makes a proper acceptance. After acceptance, a contract is formed and the offer cannot be revoked. So if Sophy offered to sell Molika her bicycle, and Molika properly accepted, Sophy could no longer revoke. Revocations are effective on receipt by the offeree, which usually means delivery to the offeree's address. Offerors can revoke by communicating directly with the offeree. Offers can also be revoked indirectly where the offeree observes that the offer is no longer open. For instance, that might occur if Molika in the example above saw that Sophy had already sold the bicycle to someone else. Public offers can be revoked in the same way the offer was made.

There may be other limits on when an offer can be revoked. In many common law jurisdictions, an offeror can generally revoke any time before acceptance. But in many civil law jurisdictions, an offeror cannot revoke for a reasonable time, unless the offer says otherwise. And offers may not be revocable even in common law jurisdictions where:

(1) an option contract holds the offer open;

(2) a special statute prevents the offeror from revoking that type of offer, such as a statute governing offers for the sale of goods;

(3) the offeree partly performs after certain unilateral contract offers;

or (4) promissory estoppel applies.

An option contract is one whose purpose is to hold an offer open. For example, Sophy and Molika might make an option contract in which Molika pays $5 in exchange for Sophy's promise to keep her bicycle sale offer open for one week. An "irrevocable" or "firm" offer for the sale of goods can occur where a merchant agrees in writing to keep an offer open for a certain time. Where an offeree partly performs in response to a unilateral contract offer, most courts say the offer cannot be revoked until the offeree has had a reasonable chance to finish performance. Finally, an offer may not be revocable where promissory estoppel applies. Promissory estoppel says that a promise may be enforceable where a party justifiably relies on it and injustice will result if it is not enforced, even where the usual requirements--such as real agreement--are not met. For example, offers may become irrevocable where a contractor relies on bids from sub-contractors in bidding to get a large contract to do construction work for a different party.

An offeree can also terminate an offer, through a rejection or a counter-offer. A rejection is basically an offeree's refusal to accept an offer. An offer terminates when the offeror receives a rejection. A counter-offer is an offer which the original offeree makes back to the original offeror, in response to the original offer. With a counter-offer, the parties actually switch places--the original offeree becomes an offeror, and the original offeror becomes an offeree! For example, if Sophy offers to repair Molika's bicycle for $5, and in response Molika offers $4, Molika has made a counter-offer. Sometimes a counter-offer looks like an acceptance, but if it changes or adds terms--if it is not a "mirror image" of the offer--it is generally a counter-offer. Counter-offers terminate the original offers on receipt, just like rejections do. However, if an offeree merely inquires about an offer, that does not end the offer. An offeree might also complain but properly accept the offer--a "grumbling acceptance." Of course, an acceptance forms a contract, and so in a sense also "ends" the offer.

***** ***CASE STUDY 11***

FACTS Sokun runs a shophouse that sells shoes. One day, Dina writes to Sokun: "I will build you a new addition to your shophouse, according to the attached plans, for $5,000." Sokun thinks about the offer. Then he sends Dina a note that says: "I accept your offer to build the new part on my shophouse, according to the plans you sent, for $4,000." Dina receives the note.

Sokun says that his response was a "grumbling acceptance," and that now there is a contract between the parties. Dina says that there is no contract yet, but that his offer to Sokun to do the work for $5,000 is still open. The parties ask a friend with contract law training to help them.

QUESTION OF LAW Is Dina's offer still open?

DECISION No. Dina's offer is no longer open because Sokun's response was a counter-offer, which terminated Sokun's offer--but there is no contract yet.

When an offeree's response to an offer changes the terms in the original offer, it is generally a counter-offer that terminates the original offer. Of course, there is no contract unless the counter-offer is accepted.

In this case, Dina offered to do some construction work for Sokun for $5,000. In response, Sokun said he "accepted" the offer for $4,000. This was a counter-offer. It may have looked like an acceptance, but because it changed the terms of the offer, it was not. This counter-offer terminated Sokun's offer. Sokun can now accept the counter-offer and form a contract, if he wishes. But there is no contract yet, because there has been no acceptance yet.

Finally, an offer may be terminated by a specific event or circumstance outside the direct control of the offeror and offeree. In particular, an offer may end because of lapse; the occurrence of a condition specified in the offer; the death or adjudicated incompetence of a party or person essential to the proposed contract; destruction of the particular subject matter of the contract; or a change in the law that makes the offer illegal. In many jurisdictions, these events can terminate offers automatically. To lapse is basically to end because of the passage of time. An offer lapses either at the time that it (or a related option contract) clearly says it will, or otherwise after a reasonable time, based on the subject matter of the contract and other circumstances. For example, if Sophy offers orally to sell Molika her bicycle at the market and says the offer is "open for a limited time," that offer will probably lapse fairly soon. The occurrence of a condition the offer specified can also terminate the offer. A condition in this situation is basically an event whose occurrence will affect whether the offer ends. For example, an offer might say it ends if the offeror fails to get a loan. The death or adjudicated incompetence of a party or person essential to the proposed contract can also terminate an offer. In addition, destruction of the particular subject matter of an offer can end the offer. This rule applies only where the offer is about a specific, identified thing, such as a particular building. Finally, a change in the law making the offer illegal can terminate the offer.

Acceptance

The other major part of a real agreement is the acceptance.

***** DEFINITION:** An **acceptance** is basically an offeree's indication of agreement with an offer.

When the offeree properly accepts a valid offer, a contract is formed. In general, acceptances can occur in a variety of ways. However, there are two kinds of limits on how proper acceptances can occur. These are requirements

of the offeror and the law. The rest of this Section will discuss how these limits affect who may properly accept offers and how proper acceptances occur.

In general, only the intended offeree can properly accept and form a contract with the offeror. An attempted acceptance by anyone else is generally a new offer to the original offeror. So if Vuthy offers to sell a book to Sakorn, an attempted acceptance by Pochin is generally not an acceptance. It is generally a new offer to Vuthy. However, in two situations, even a party with whom the offeror did not want a contract can form one. The first situation is where a party who is not an intended offeree receives an offer by mistake and accepts it without knowing or having a reason to know of the mistake. In the book example, that might occur if Pochin received the offer, really thought it was for him, and had no reason--such as a different name on the offer--to know of the mistake. The second situation occurs where the offeror creates more offerees than he really wants, and more offerees accept than the offeror wanted.

In common law jurisdictions, how an offeree can properly accept depends on whether the offer is for a unilateral contract or a bilateral contract. In these jurisdictions, where the offer is for a unilateral contract, the offeree can properly accept by fully performing the act requested. Many jurisdictions traditionally said that offerees generally had no obligation even to notify offerors that they were performing the act, since the act by itself created the contract. However, the offeree must tell the offeror about the acceptance if the offer requests it. Some jurisdictions also say that the offeree must use reasonable efforts to notify the offeror if the offeror would otherwise have no adequate way to learn of the performance. For example, suppose Vuthy told Sakorn that he would pay him 2,000 riels if Sakorn delivered a particular book to a certain place. Sakorn could generally accept by delivering the book, and nothing more would be needed. But if Vuthy's offer asked for notice from Sakorn, or in some jurisdictions if Vuthy had no adequate way to know of the acceptance--such as if Vuthy was far from the place of delivery and had no way to know about it--then Sakorn would be required to notify Vuthy.

In common law jurisdictions, where the offer is for a bilateral contract, the offeree can generally accept by communicating in a proper manner the promise requested. This rule can be divided into four important general requirements. Specifically, a proper acceptance of an offer for a bilateral contract must generally:

(1) be communicated to the offeror;

(2) be unequivocal and unconditional;

(3) be identical to--or "mirror"--the terms of the offer;

AND (4) occur in a proper manner, including meeting any special requirements of the offeror.

First, to accept an offer for a bilateral contract, the offeree must communicate the acceptance to the offeror. In general, an offeree can communicate his acceptance through words (expressly) or conduct (impliedly). Of course, it must be clear from an acceptance by conduct that the offeree is actually making the promise the offeror wanted. For instance, if Vuthy offered to sell Sakorn a book if Sakorn promised to pay 2,000 riels, Sakorn might be able to accept simply by nodding his head or making some other positive gesture, as long as it clearly showed that he accepted the offer.

However, silence by the offeree is generally not an acceptance. So there is generally no contract if an offeree does not respond to an offer. However, in four situations silence actually can be a proper acceptance. The first occurs where the parties have previously agreed the offeree could accept through silence. The second occurs where prior similar dealings between the parties would indicate to a reasonable person that silence was an acceptance. For instance, in the book example, if Vuthy had offered to sell Sakorn a number of books in the past, and the parties' practice was that Sakorn only responded if he did not want a book, Sakorn's silence might actually be an acceptance. The third situation is where a trade usage or industry practice is that silence can be acceptance. The fourth situation occurs where the offeree substantially uses or controls the subject matter of the offer. If Vuthy lets Sakorn examine the book he is offering to sell, and Sakorn walks away and does not return the book for a long time, a court might find that this was an acceptance! But this exception does not apply where aggressive sellers try to force goods or services on parties without giving them a reasonable opportunity to object. So if Vuthy actually sends Sakorn the book through the mail along with his offer, and Sakorn does not respond--perhaps because he is too busy, or does not wish to spend his time and money replying or returning the book--there is probably no contract.

Second, an acceptance of a bilateral contract offer must generally be unequivocal and unconditional. So the acceptance must: (1) show the offeree's present agreement to the offer, and (2) not depend on any change to the offer. The acceptance generally cannot say things like "I might agree to your offer," or "let's agree to agree later." Also, the acceptance generally cannot depend on conditions, such as "I accept your offer subject to these changes." For instance, suppose Sakorn responded to Vuthy's book sale offer by saying: "I agree only if the price is 500 riels." That would not be an acceptance, but a counter-offer.

Third, the acceptance must generally be identical to the terms of the offer. This important general rule is sometimes called the "mirror image" rule, since the acceptance must look like the offer would in a mirror! Suppose an employer offers to hire a worker for $500 per month, and the worker says "I accept at $600 per month." That is not a proper acceptance.

In some jurisdictions, there is an exception to the mirror image rule with regard to sale of goods contracts. Some jurisdictions basically say that a response to an offer for the sale of goods which is a definite expression

of acceptance is proper even if it includes new or different terms. But those terms only become part of the contract formed in very limited circumstances. For example, in some jurisdictions in the United States, "material" (important) changes in such acceptances only become part of the contract where the offeror actually agrees. In such jurisdictions, "non-material" (not so important) changes only become part of the contract formed where both parties are merchants, the offer did not limit acceptance to the terms of the offer, and the offeror does not object.

******* ***CASE STUDY 12*** **(U.S. commercial code)**

FACTS Vuthy offers to sell Sakorn a book for 2,000 riels. In response, Sakorn says: "I accept at 1,000 riels, and you provide me the book in a plastic bag." Vuthy objects to these changes.

QUESTION OF LAW Is there a contract here?

DECISION Yes. A contract exists because Sakorn made a definite expression of acceptance, but the changes in his statement are not in the contract.

A definite expression of acceptance to an offer for the sale of goods is proper even though it varies terms in the offer. However, material changes only become part of the contract formed where the offeror agrees, and non-material changes only do where both parties are merchants, the offer allows it, and the offeror does not object.

In this case, Sakorn's definite response to Vuthy's book sale offer formed a contract, even though it changed the offer. However, the price change did not become part of the contract, since it was a material change and Vuthy did not agree. And the bag change did not become part of the contract even though it was not material, because Vuthy objected. So the parties have a book sale contract for 2,000 riels with no bag term.

Fourth, the acceptance must occur in a proper manner. It must comply with any special instructions of the offeror as to the manner of acceptance. If the offeror expressly insisted on just one manner of acceptance, only that manner will create a proper acceptance. However, if the offeror did not expressly insist on just one manner, then the acceptance is proper if made in a manner that is reasonable under the circumstances. In general, this means the offeree should use a manner that is the same as, similar to, or better than the manner in which the offeror made the offer. For example, if Vuthy made his book sale offer to Sakorn by regular mail, it would be reasonable for Sakorn to accept by regular mail, or by fax or hand delivery, since those are probably faster and more reliable than mail.

An acceptance may be effective at the time of dispatch or the time of receipt. Rules about when an acceptance is effective can be difficult. It seems

that many civil law jurisdictions say acceptances are effective when the offeror receives them (effective on receipt). But many common law jurisdictions basically say acceptances are effective when the offeree sends them (effective on dispatch) if the offeree sends them diligently and in a reasonable manner. Otherwise, they are effective on receipt, providing they actually arrive in a way that is as satisfactory as if they had been sent diligently and in a reasonable manner. The "effective on dispatch" rule can sometimes mean that acceptances are effective even though a revocation or rejection was sent first! For instance, suppose Sakorn sent an acceptance to Vuthy diligently and in a reasonable manner. That acceptance would be effective on dispatch--even if Vuthy had already sent a revocation, as long as that revocation had not yet been received.

Where it is not clear whether an offer is requesting an act or a promise--a unilateral or a bilateral contract--it appears that most courts say the offeree can accept either by performing the act or making the promise. For example, if it was not clear whether Vuthy's book sale offer was requesting that Sakorn promise to pay, or simply pay, Sakorn could accept either way.

Illustration: Basic, General Elements of Real Agreement

Valid OFFER	+	**Proper ACCEPTANCE**	=	**REAL AGREEMENT**
(1) Seriously intended; (2) Definite and reasonably Clear; (3) Communicated to offeree; AND (4) Not Ended by offeror revocation, offeree rejection or counter-offer, or other event or circumstance.		(1) Unilateral: Fully Perform act requested (2) Bilateral: (a) Communicated to offeror; (b) Unequivocal and Unconditional; (c) Identical to offer (mirror image); AND (d) Occurs in proper Manner.		

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)") discusses the key requirement of real agreement more fully.

1.4b To Be Valid, a Contract Must Generally Have Consideration in Common Law Jurisdictions

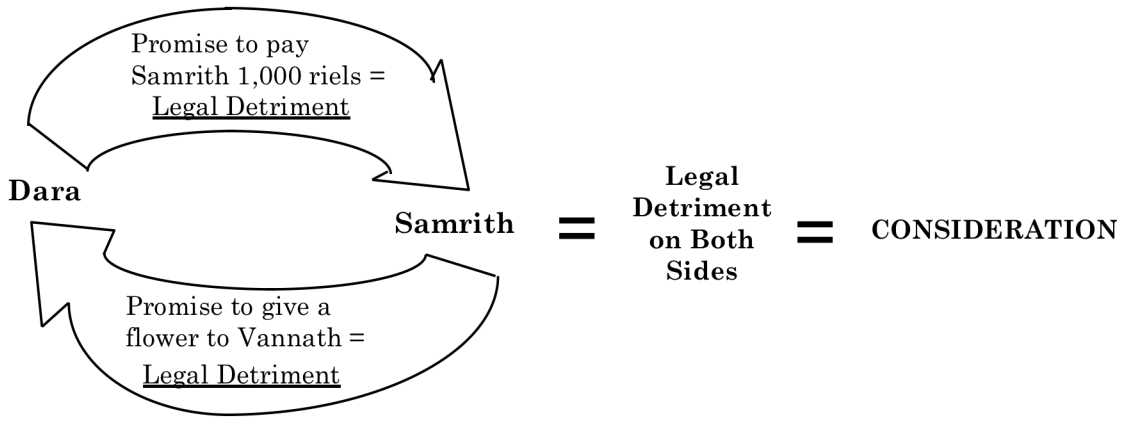
Common law jurisdictions generally require consideration.

*** **DEFINITION: Consideration** is the new "legal detriment" to each party to a contract, which generally means what each party does or agrees to do in exchange for a promise or performance from another party.

While common law jurisdictions generally require consideration, civil law jurisdictions do not require it in order for a contract to be enforceable.

This general common law requirement means that each party to an agreement must do or agree to do something that he was not required to do before--that he must have some new "legal detriment"--or the agreement is void. Consideration may be a promise to do something, such as pay money, or not do something, such as not smoke cigarettes. Consideration need not actually benefit any party to a contract. So if Dara agrees to pay Samrith 1,000 riels in exchange for Samrith's promise to give a flower to Vannath, there is consideration. It appears that Dara will receive nothing, but both Dara and Samrith have legal detriment. Consideration measures whether a party really wanted his promise to bind him legally.

Illustration: How Consideration Works



Consideration must be legally sufficient. This does not mean that it must be equal on both sides, or that the exchange of detriment must be "fair." It means only that the consideration on each side must be not obviously worthless--such as a piece of dirt. But generally, even something as small as a peppercorn (a famous common law example) is legally sufficient.

It is important to know what is generally not consideration. First, a performance of or promise to perform a pre-existing duty is generally not consideration. If Samrith makes a contract to sell Dara a flower for 1,000 riels, then Samrith says he wants 2,000 riels, and Dara agrees, there is generally no consideration, because Samrith had a pre-existing duty to supply the flower. Second, a legally unenforceable promise--a promise not to do something a party has no right to do anyway, such as commit a crime--is not consideration. Third, past consideration (an act done before the contract is made) is generally not consideration. That might occur if Samrith agrees today to provide Dara a flower because Dara gave him 1,000 riels last week. Fourth, an illusory promise, which does not actually commit a party to do anything, is not consideration. But if a seller agrees to sell all the goods he

will produce in a certain period to a certain buyer (an output contract), or a buyer agrees to buy all the goods he will need in a certain period from one seller (a requirements contract), consideration exists. Fifth, love and affection are not consideration.

******* ***CASE STUDY 13***

FACTS Sokha says to his good friend Hen: "I like you very much, so I offer to give you this new car now. Do you accept?" Hen replies: "Yes."

QUESTION OF LAW Is there consideration in this agreement?

DECISION No. There is no consideration because Hen has no legal detriment--no duty to do anything he did not have to do before.

Consideration exists where all parties to a contract have some new legal detriment, which means doing or promising to do something they were not required to do before. In this case, Sokha promised to give Hen a new car. But Hen did not promise to do anything in return! So there is no consideration. This agreement would not be enforceable in a common law jurisdiction.

The partial payment of a debt is generally not consideration for the cancellation of the debt. However, some jurisdictions make exceptions in certain situations, such as where there is a good faith dispute about the debt amount; the debtor promises a new substitute performance; or the creditor "cancels" and returns to the debtor written evidence of the debt.

In many jurisdictions, modifications of existing contracts generally require new consideration. But this rule may not apply where a modified agreement is a mutual rescission (canceling of the contract); a party has unforeseen and substantial difficulties in performing; or there is a good faith modification of a sale of goods contract. For instance, in the example above for the sale of a flower--goods--some jurisdictions say that if Samrith and Dara agree in good faith to change the price to 2,000 riels, consideration exists.

There are many exceptions to the general common law rule that consideration is required. Many jurisdictions do not require it for:

(1) promises to make charitable donations;

(2) new promises to pay debts discharged in bankruptcy;

(3) contracts under seal;

(4) new promises to perform contracts unenforceable because of statutes of limitation;

(5) new promises to perform contracts unenforceable because of failure to meet writing requirements;

(6) firm offers for or modifications of sale of goods contracts; or

(7) promises that meet the requirements of promissory estoppel.

So if Dara never paid Samrith for the flower and the statute of limitations expired, a new promise by Dara to pay would not require new consideration.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration") contains a more complete discussion of the common law requirement of consideration.

1.4c To Be Valid, a Contract Must Satisfy Legal Requirements as to the Capacity of the Parties

Contracts must also meet legal requirements as to capacity.

*** **DEFINITION:** **Capacity** is a person's legal power or qualification to do what adults generally have the legal power or qualification to do.

In contract law, capacity means a person's ability to make an enforceable contract. In general, a person has capacity if he can understand the nature of the contract, can control his actions in making it, and the law permits him to make it. Contracts made by parties who lack capacity may be voidable or void, depending on the extent of the parties' lack of capacity.

Living adults generally have full capacity to make contracts. Legal entities such as governments and corporations also generally have capacity. However, certain types of persons may not have full capacity to make contracts. Dead persons cannot form contracts. And the following types of living persons may also lack capacity to some extent:

(1) minors;

(2) mentally incompetent persons;

(3) intoxicated persons;

(4) persons convicted of and imprisoned for serious crimes; and

(5) in very limited situations, foreigners.

Contracts minors make are generally voidable by the minor. In many jurisdictions, the age of majority is 18 years. As noted in Section 1.3a, the minor can disaffirm (properly indicate that he will avoid) or ratify (properly indicate that he intends to be bound by) the contract. If the minor disaffirms, the contract cannot be enforced. So if a minor named Ray agrees to buy rice from Samoeun, but Ray refuses to perform, Samoeun cannot enforce the contract. A minor can generally disaffirm any time during minority, and for a reasonable time after he reaches majority. If a minor disaffirms a contract, he can generally get restitution of what he has given to the other party, or its reasonable value. Most courts say the other party can also get restitution from the minor, but only of what the minor still has. If the minor ratifies, the contract can be enforced like a valid contract. A minor cannot ratify a contract until he reaches the age of majority and gains full capacity. If the minor

is silent about a contract for a reasonable time after he reaches majority, this disaffirms executory contracts, but ratifies executed contracts.

***** ***CASE STUDY 14***

FACTS Vouthy is 16 years old. The age of majority is 18. Vouthy buys a television from Samnang, an adult. A few months later, Vouthy's parents persuade him that the television purchase was not a good idea. Vouthy tells Samnang he wants his money back. Samnang refuses to give the money back.

QUESTION OF LAW Can Vouthy disaffirm and get his money back?

DECISION Yes. Vouthy can disaffirm this contract and get his money back, because he is a minor who has the right to avoid the contract.

Minors can generally disaffirm contracts they make, up until a reasonable time after they reach the age of majority. In this case, Vouthy bought a television from Samnang while he was a minor, but a few months later decided to disaffirm the contract. Vouthy can disaffirm and get his money back from Samnang. Of course, Vouthy must also give the television back to Samnang, if Vouthy still has it.

Some jurisdictions limit the ability of minors to disaffirm certain contracts, such as those for "necessaries," business contracts, contracts based on misrepresentation of the minor's age, and real estate contracts. "Necessaries" are items needed to sustain life, generally including food, clothing, and shelter. If a minor's contract for necessaries has been partly or fully executed, the minor is liable for the reasonable value of what he has received (restitution). Business contracts of minors are generally valid. Where a minor makes a contract by lying about his age, courts allow him to disaffirm, but may require that he return the reasonable value of what he has received under the contract, whether he still has it or not. Finally, some courts say a minor cannot fully disaffirm a contract for the sale of real estate until reaching majority. One way to safely make contracts with minors is to require a co-signer, such as a parent.

Contracts mentally incompetent persons make are generally void or voidable. In particular, many jurisdictions say contracts of persons who have been declared incompetent by a court are void, while those of incompetent persons who have not been declared incompetent by a court are voidable. Basically, a person is incompetent where he: cannot understand the nature of a particular contract; or cannot control his behavior with regard to the contract, and the other party has a reason to know that. For example, if Sary agrees to do one day of construction work for Lundy for $10,000, but Lundy really cannot understand the nature of that agreement, the agreement is probably voidable by Lundy. Incompetent persons can disaffirm or ratify their voidable contracts, as minors can. But when incompetent persons disaffirm, most courts say they must generally provide restitution of the

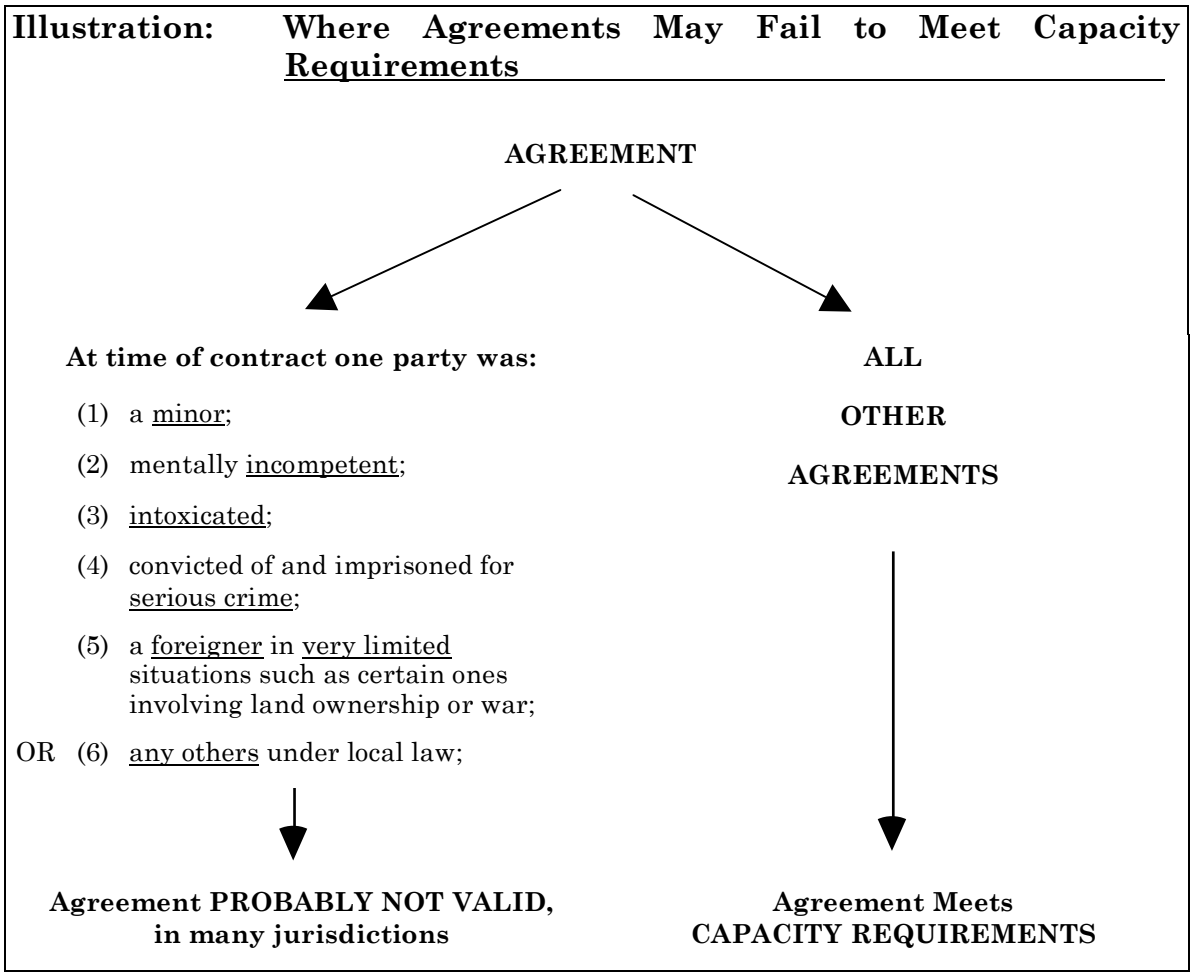
reasonable value of what they have received--whether they still have it or not--especially in the case of necessaries. Incompetent persons can ratify only when they gain capacity.

Contracts intoxicated persons make are generally voidable. The rules about this are similar to those for unadjudicated mentally incompetent persons. However, many courts say contracts of an intoxicated person are valid if the person was voluntarily intoxicated for reasons other than an illness and the other party had no reason to know of the intoxication. So if Sary and Lundy make an agreement while Lundy is voluntarily too drunk on vodka to understand it, and Sary has no reason to know that, the agreement is valid.

Parties convicted of serious crimes may lack full capacity to contract. Such limits generally apply only while such persons are imprisoned.

Foreigners generally have full capacity to make contracts. Some jurisdictions limit the ability of foreigners to own land. Many jurisdictions limit the ability of foreigners to make contracts with the jurisdiction's citizens while the foreigner's nation is actually at war with the nation of those citizens.

Illustration: Where Agreements May Fail to Meet Capacity Requirements



*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity") contains a more complete discussion of the general requirement of capacity.

1.4d To Be Valid, a Contract Must Satisfy Legal Requirements as to Legality

Agreements that violate specific statutes or public policy are generally void and unenforceable. By "specific statute," this text means a statute that discusses the actual subject matter of the agreement, such as the sale of opium. "Public policy" basically means the promotion of the good of society. It may apply where no specific statute forbids the making or performance of the agreement.

Agreements that violate specific statutes--criminal or civil--are generally not enforceable. Such statutes may include:

(1) criminal and tort statutes;

(2) gambling statutes;

(3) usury statutes;

(4) regulatory licensing statutes; and

(5) unreasonable restraint of trade statutes.

Courts will not enforce agreements to commit crimes or torts. Torts are non-contractual civil wrongs, which civil law jurisdictions define in statutes, but common law jurisdictions often define in court precedent.

*** ***CASE STUDY 15***

FACTS Serey and Chhay agree to rob the Foreign Jade Bank and divide the money equally. Then they rob the Bank. But after the robbery, Chhay refuses to give Serey his share of the loot! Serey asks the court for help.

QUESTION OF LAW Will the court enforce this agreement?

DECISION No. The court will not enforce this agreement because it is an agreement to commit a crime--an illegal agreement.

Agreements to commit crimes are void and unenforceable. In this case, Serey and Chhay agreed to rob a bank. That is a crime. So this agreement is not enforceable, and the court will not enforce it for Serey.

Many courts do not enforce gambling agreements. Gambling is often banned or regulated by statute. Some jurisdictions will not enforce gambling agreements even if the gambling is legal! Of course, such courts would be refusing to enforce on the basis of public policy. So if Sovath and Thida bet illegally on the result of a soccer match, the agreement could not be enforced.

Usurious loan agreements cannot be enforced beyond the legal interest rate. Different jurisdictions may enforce such agreements at the legal rate, at no rate (0%), or not at all. So if Sovath loaned Thida money at 50% interest

where the legal limit was 20%, the agreement could not be enforced beyond 20%.

Certain agreements made by those who have violated regulatory licensing statutes are not enforceable. Such statutes mainly protect the public's welfare, rather than simply raise government funds. So an unlicensed lawyer could not enforce a fee agreement, since attorney licensing statutes protect the public's welfare by trying to ensure that attorneys are competent.

Agreements that unreasonably restrain trade in violation of statutes are generally unenforceable. Such agreements harm competition or restrict a party's freedom to do business as he chooses. Examples include agreements to fix prices, limit production, or divide territory and exclude competitors.

Many jurisdictions also say agreements are unenforceable in limited situations where they violate public policy, even though they do not violate a specific statute. Public policy is basically the promotion of the common good and well-being of society. It may be found in statutes and other government actions, court decisions, and elsewhere. But public policy must be clear and widely recognized for a court to refuse to enforce an agreement on that basis. Some key types of agreements that may violate public policy are those that:

(1) involve the commission of torts;

(2) harm the freedom of marriage;

(3) harm the administration of justice;

(4) harm public service or interfere in public affairs;

(5) unreasonably restrain trade;

(6) promote immorality; or

(7) contain improper exculpatory clauses.

Agreements to commit torts cannot be enforced even where the tort is not defined in a statute, as often occurs in common law jurisdictions. So Sovath cannot enforce an agreement in which Thida agreed to hit Vuth--a tort.

Agreements which harm the freedom of marriage are not enforceable. The rules about this vary in different jurisdictions. Courts may refuse to enforce agreements to marry, agreements not to marry, and marriage brokerage agreements. For example, in many jurisdictions, Thida's father could not enforce an agreement in which Thida promised not to marry Sovath.

Agreements that harm the administration of justice are unenforceable. So an agreement in which Thida agreed to bribe a police officer or a judge in order to influence the outcome of a case could not be enforced.

Agreements that harm public service (official corruption) or interfere in public affairs are unenforceable. Official corruption occurs where a

public official performs official acts on the basis of bribes, rather than the best interests of his society. Such corruption may take many forms, including bidding corruption. So an agreement in which a contractor agrees to pay a public official money in exchange for getting a new road construction contract is unenforceable. Important types of agreements that interfere in public affairs are those that harm a nation's security or its relations with other nations, such as an unauthorized agreement to sell national secrets to a foreign government.

Agreements that unreasonably restrain trade are unenforceable even if they do not violate specific statutes, as may occur in common law jurisdictions. These include agreements not to compete. Many jurisdictions will enforce such agreements only if restricting competition is not the main goal of the agreement and the restriction is reasonable as to time and place. If a welder named Sovath promises his employer Thida that he will never work as a welder for anyone else in Cambodia, that is probably an unreasonable restriction. Exclusive dealing agreements may also unreasonably restrain trade.

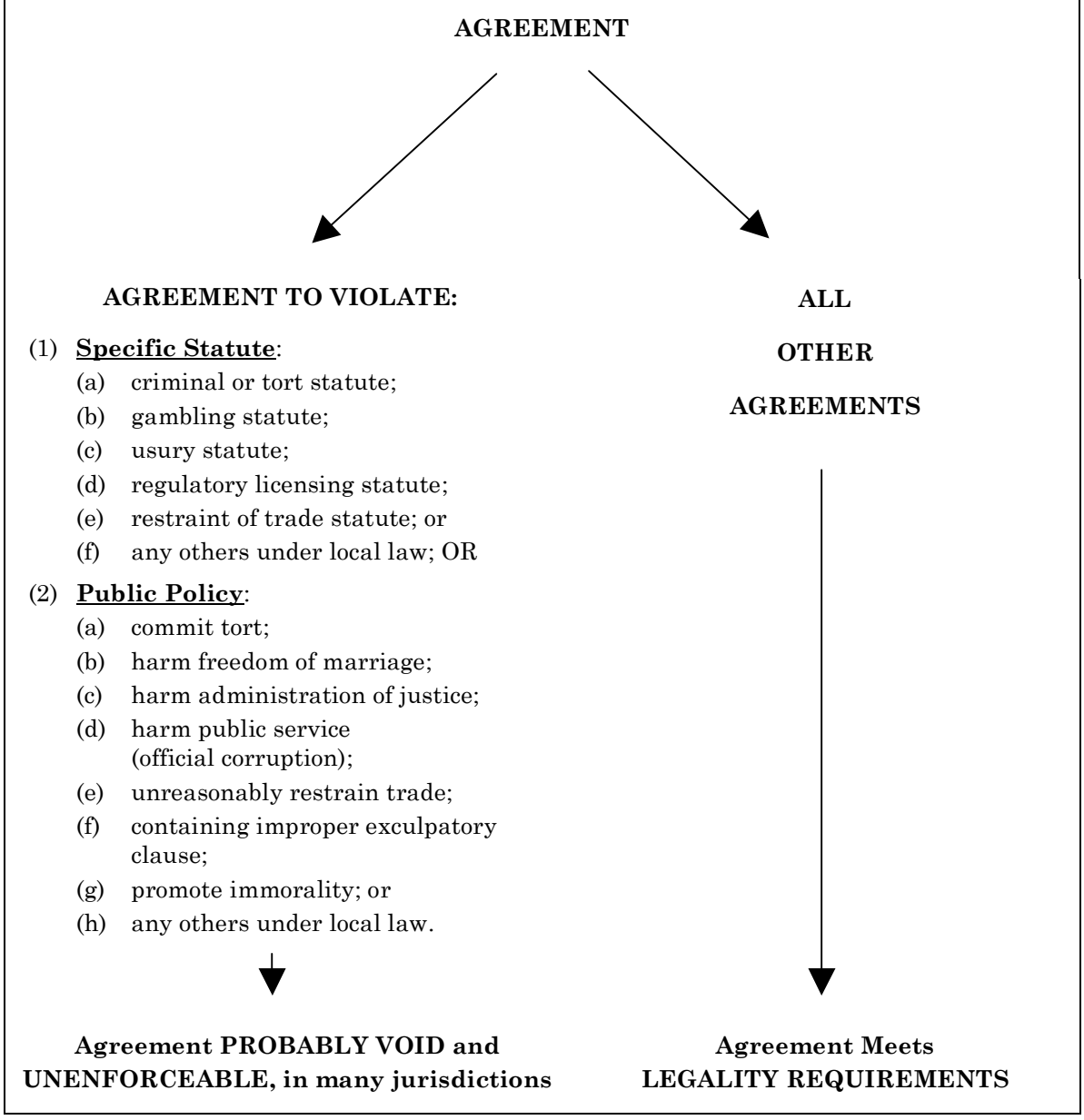
Exculpatory clauses are not enforceable as to intentional or reckless torts, but they may be enforceable as to negligent torts if it does not violate public policy. Exculpatory clauses in contracts try to relieve parties from liability for future harm, usually for torts. Businesses often use them in standard form contracts.

Agreements that promote immorality cannot be enforced. This limited rule applies only in the few appropriate cases where the above rules do not. For example, it might apply where a person sells a land mine to someone the seller knows will immediately blow up a bridge, even if land mine sales are generally legal.

Illegal agreements are generally void and unenforceable. But certain parties may be able to enforce them in limited cases. A worker may be able to enforce a labor agreement that violates a minimum wage law--but at the legal minimum wage. Courts rarely order even restitution for parties to illegal agreements. But they may do so for a party: who is significantly less "guilty" than the other party; or who withdraws before an agreement's improper goal is reached, and who has done nothing seriously wrong. Courts may be able to fairly sever illegal parts of agreements and enforce the rest. Improper exculpatory clauses might be severed. But agreements like the one in Case Study 15 are not severable.



Illustration: Where Agreements May Fail to Meet Legality Requirements



*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality") contains a more complete discussion of the requirement of legality.

1.4e To Be Valid, a Contract Must Satisfy Legal Requirements as to Formality

In many jurisdictions, contracts must meet certain formality requirements to be enforced. The most important are writing requirements.

In general, both written and unwritten contracts can be enforced. But all important contracts should be written. This provides better evidence. And

certain important contracts must be written to be enforceable. Five important types of contracts that many jurisdictions say must be written are:

(1) agreements to transfer a substantial interest in land;

(2) agreements that cannot be performed within one year;

(3) suretyship agreements;

(4) certain agreements relating to marriage or promises to marry;

and (5) agreements for the sale of goods over a certain money amount.

However, many jurisdictions say these requirements do not apply where the contract has been fully executed, where the party against whom the agreement is to be enforced has admitted in court that the contract exists, or where promissory estoppel applies.

Agreements to transfer a substantial interest in land must generally be written to be enforceable in most jurisdictions. This rule generally applies to agreements for the sale of land, leases and easements over one year, mortgages, and the sale of rights to timber, minerals, or similar materials (but not crops) to be removed by the buyer. The rule may not apply to a buyer who has partly performed and substantially relied, such as by improving the property.

***** ***CASE STUDY 16***

FACTS Serey and Tech orally agree that Tech will buy Serey's land for $100,000. But later Tech changes his mind and refuses to perform.

QUESTION OF LAW Will the court enforce this land sale agreement?

DECISION No. The court will not enforce the land sale agreement between Serey and Tech because it failed to meet a writing requirement.

Agreements for the transfer of substantial interests in land must generally be written to be enforced. In this case, Tech orally agreed to buy Serey's land. This was an agreement for the transfer of a substantial interest in the land: its sale. But the agreement was oral. So it cannot be enforced.

Agreements which cannot possibly be performed within one year of the time the agreement was made must generally be written to be enforced in many jurisdictions. So under this rule, an oral agreement in which Thanna agreed to work for Bora for two years could not be enforced, since it could not possibly be performed within one year of the time it was made. However, some courts will enforce such oral agreements if one party has already fully performed.

Suretyship agreements must generally be written to be enforced in many jurisdictions. These are agreements in which a "surety" becomes

responsible for the obligations of a debtor to a creditor. The surety agrees to perform if the debtor does not. So an oral agreement in which Thanna agreed to pay Bora's debts if Bora did not pay could not generally be enforced. This rule applies to agreements of an executor or administrator of a deceased person's estate to pay the estate's debts from his own funds. Some courts do not apply the rule where the main purpose of the agreement is to financially benefit the surety.

Agreements where one person promises something in exchange for marriage or a promise to marry must generally be written in some jurisdictions (assuming the agreement is enforceable at all). The basic purpose of this general rule appears to encourage parties to think carefully--as writing a contract usually does--before marrying for reasons other than affection. The rule does not apply to agreements that are no more than mutual promises to marry, such as if Saray and Bunny simply promised to marry each other.

An agreement for the sale of goods over a certain monetary amount must generally be written to be enforceable in many jurisdictions. The money amount varies in different jurisdictions. If it was $500, Bora's oral agreement to buy $700 of rice from Thanna could not generally be enforced. But some courts will enforce such oral sale of goods agreements to the extent of any part performance, and in certain cases for specially manufactured goods.

Jurisdictions may require a variety of other types of agreements to be written to be enforced. Examples include contracts for the sale of securities, and promises to pay debts already discharged in bankruptcy proceedings.

Modifications of contracts are subject to the same writing requirements as the original contracts. There, the parties are really making a new contract.

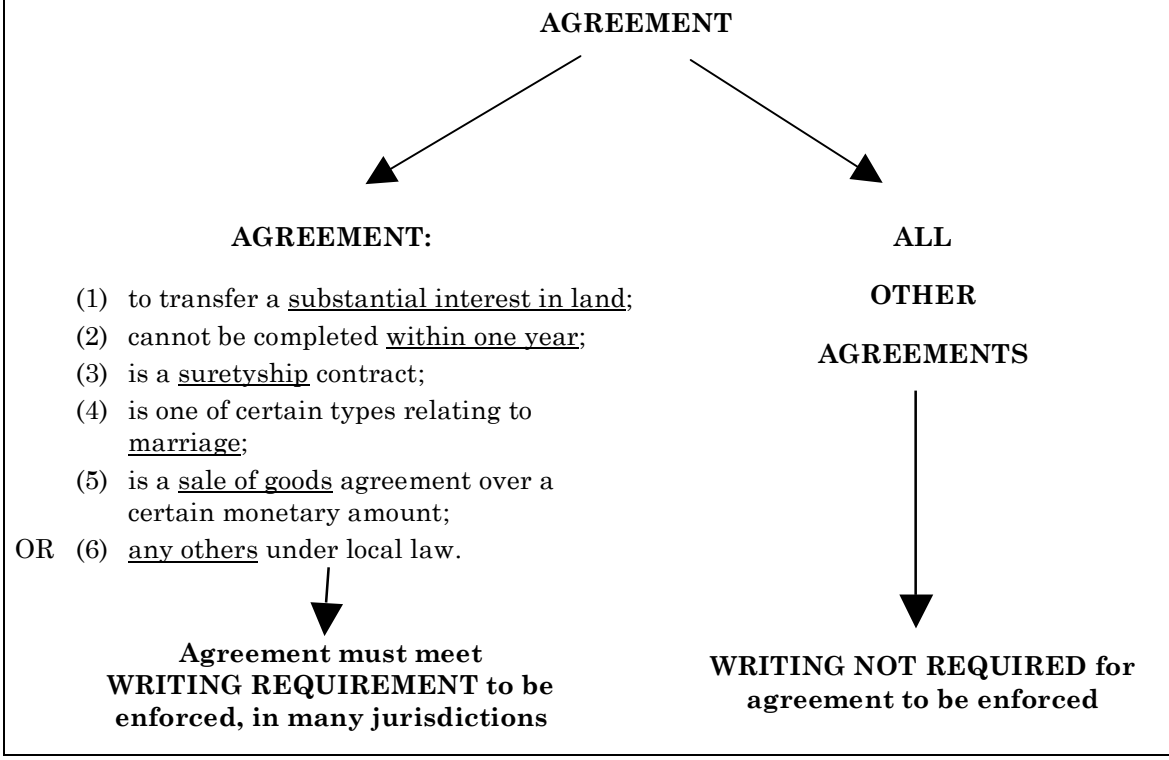
When the law requires a writing, the writing must be sufficient. In general, the law is flexible about the physical form of the writing. It can be a long formal document, but also a simple note or receipt. It can be in several different writings. The law is also flexible about the circumstances in which the writing was created. It can be made for a purpose other than enforcing the agreement (such as simply to tell someone else about the agreement). It can even be made after the actual agreement of the parties occurs! But to be sufficient, many courts say the writing must contain the essential terms of the contract, the identities of the parties, and the signature of the party against whom the contract is being enforced. For sale of goods, the essential terms are probably the identity and quantity of the goods. So Bora's agreement to buy rice from Thanna might be enforced even if it was just a signed note saying "2 tons rice."

The general effect of failure to meet a writing requirement is that the agreement cannot be enforced, but as noted above, there are many exceptions.

And parties can generally get restitution of what they provide to other parties under such agreements.

There are formality requirements other than writing requirements. For example, certain contracts may be required to be registered or notarized.

Illustration: Where Agreements May Fail to Meet Formality Requirements



*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality") discusses formality requirements, particularly writing requirements, more fully.

1.4f To Be Valid, a Contract Must Not Have Any Other Formation Problems

Other contract formation problems may affect whether agreements are enforceable. The nature and effects of these other problems vary a lot, so they will be discussed separately below. The problems to be discussed relate to:

(1) mistake;

(2) misrepresentation;

(3) duress;

(4) undue influence;

(5) unconscionability; and

(6) promissory estoppel.

Agreements resulting from a mistake may be void or voidable. Rules in this area are often difficult and confusing. A mistake is a belief that is not in accord with the facts. In general, mistakes affect the enforceability of contracts only if they are about existing facts--not opinions or predictions. How a mistake affects the enforceability of an agreement often depends on whether it is a bilateral or unilateral mistake.

Bilateral mistakes are those made by both parties. An agreement resulting from such a mistake is void if the mistake is so serious that there really is no "agreement" that the courts can fairly enforce. This is rare, but may occur where the parties make mistakes about the existence of the specific subject matter, or the meaning of material terms. An example would be where Vichda agrees to sell Vandy a particular car, but unknown to the parties the car has already been destroyed by a flood.

An agreement resulting from a bilateral mistake is voidable by the party hurt by the mistake if the mistake is basic and has a material effect on the agreement, and the party seeking to avoid the agreement has not assumed the risk of that mistake. The law may assign such risks to certain parties. In general, each party assumes the risk that he will be wrong about an item's financial value. But parties may be able to avoid agreements because of mistakes about the quality or physical nature of the subject matter, such as a mistake about whether a cow is pregnant at the time of its sale.

Unilateral mistakes are those made by only one party. An agreement resulting from a unilateral mistake is void if the mistake is so serious that there really is no "agreement" that the courts can fairly enforce. This might occur where a party mistakenly transmits an offer to an unintended party who tries to accept, even though he knows or has reason to know of the mistake.

An agreement resulting from a unilateral mistake is voidable in many jurisdictions under the same rules as a bilateral mistake, except that there is an additional requirement: either the other party must have caused or had reason to know of the mistake, or enforcing the agreement must be unconscionable (extremely unfair). Obviously, this additional requirement makes it harder to avoid contracts because of unilateral mistake. However, four important situations where it might be possible are with mistakes involving: (1) the identity of the other party; (2) the nature of the subject matter of the contract; (3) the computation of prices in the contract; and (4) a failure to read carefully the written agreement. Parties may not always assume the risk that they will make a serious error in price computation, especially with regard to complex contracts. Parties generally cannot avoid a contract because they made a mistake by failing to read the contract carefully. But such avoidance might be possible where there is an adhesion contract--generally form agreements written by a stronger party about which there is little chance for negotiation--in which case the weaker party might avoid terms he would not have expected. Or such avoidance might occur where the written

document differs from the parties' prior oral agreement, in which case the court might reform the writing to reflect the prior agreement.

So mistakes can result in agreements that are void or voidable. Parties can generally rescind (cancel) such agreements and get restitution.

***** ***CASE STUDY 17***

FACTS Phally and Molika negotiate and sign a long English-language agreement in which Phally agrees to buy Molika's hotel. Later, Phally learns that the written agreement says that the hotel's huge generator is not included in the contract! Phally tries to avoid the contract, saying his English is not strong and he never knew that the "no generator" term was part of the contract.

QUESTION OF LAW Can Phally avoid this contract on the basis of unilateral mistake?

DECISION Probably not. It is unlikely that Phally can meet all the requirements to avoid this contract, since in this case it appears that he basically failed to read the written agreement carefully enough, and failed to have it explained to him.

A party can avoid an agreement where a unilateral mistake is basic and about a material fact; the party did not assume the risk of the mistake; and either the other party knew of or caused it, or enforcement would be unconscionable. But parties generally assume the risk of failing to read a written agreement carefully.

Here, Phally signed an agreement to buy a hotel without knowing the agreement did not include the hotel generator. Phally probably assumed the risk of this mistake, since it seems that he failed to read the agreement carefully. There is no evidence that this is an adhesion contract, or that the parties had a different prior agreement about the generator. Phally probably cannot avoid this contract.

Most agreements resulting from misrepresentations of material facts are voidable. A misrepresentation is a statement that is not in accord with the facts. Misrepresentations may be fraudulent (intentional) or innocent (unintentional).

Agreements resulting from misrepresentation about the formation of the agreement are void. What this text calls "misrepresentation about the formation" occurs where the victim of the misrepresentation did not have a reasonable chance to know the basic nature of the agreement--as might happen where the other party deceived the victim about what he was signing!

Agreements resulting from misrepresentation in the inducement of the agreement are voidable if one party misrepresents a material fact about the agreement and the other party justifiably relies on it in making the agreement. A "material fact" is one that is important to a party's decision to make or not make a contract. This rule does not generally apply to predictions or opinions, although it may in certain cases where the speaker has a fiduciary relationship with a special duty to act for another party, or special knowledge not available to the other party. This might occur where an attorney speaks with a client. Fraud in the inducement may be affirmative, involving actual false statements, such as if Vichda falsely claimed the moto he was selling could travel at a speed of 50 kilometers per hour. Or it could be a concealment or failure to disclose. Parties generally have no duty to disclose information. But there are exceptions where parties actively conceal facts, or keep silent when they have a duty to speak. That might occur where there is a fiduciary relationship, where a party's past statements have become inaccurate, or where a party knows the other party is mistaken about a basic assumption. Concealment might exist where Vichda actively concealed the fact that the moto he was selling had already traveled 50,000 kilometers by removing the odometer.

Agreements resulting from duress are voidable. In this situation, duress is using an improper threat to induce a party to make a contract. Improper threats are generally those to commit crimes or torts that will harm the victim, his family or his property. So duress would exist if Molika threatened to harm Phally's child if Phally did not sell her his moto, and Phally could avoid an agreement made on that basis. Other examples include threats to blackmail persons, and threats not to perform existing contracts in order to get a contract modification where there is no legitimate commercial reason.

Agreements resulting from undue influence are voidable. Undue influence is improperly influencing a party to make an unfair contract, often through a relationship of trust or confidence, even though no threats are made. This seems to occur most often where fiduciary relationships are involved. For example, if Vichda is a doctor who persuades his patient Vandy to buy $10 worth of medicine from him for $100, that might be undue influence.

In very limited situations, courts may refuse to enforce agreements because they are unconscionable. In many jurisdictions, unconscionable agreements are those whose process of formation or actual provisions are so unfair that they "shock the conscience" of the court. This occurs rarely.

Procedural unconscionability is caused by extreme unfairness in the way the agreement is formed. It typically occurs where one party is induced to make the agreement without having any real choice or ability to bargain about the terms. This is possible particularly with adhesion contracts. These are contracts written completely by a party with much greater bargaining power,

where the other party has no real chance to negotiate about the terms, which are usually standardized, hard to understand, and unfair.

Substantive unconscionability is extreme unfairness in the actual terms of the agreement. Agreements may be substantively unconscionable where they charge grossly excessive prices or improperly interfere with legal remedies. That might occur if Vichda's contract to sell his car to Vandy: improperly tried to limit warranties the law often implies to protect consumers, such as the warranty of merchantability; or contained an improper exculpatory clause.

Courts usually say unconscionable agreements are unenforceable. But if the unconscionable part can be properly reformed or severed, as a remedy meddling provision might, the court might do that and enforce what remains.

Where the common law doctrine of promissory estoppel (detrimental reliance) applies, a promise may be enforceable if a party justifiably relied on it--even though there is no valid agreement! Promissory estoppel requires:

(1) a real case brought to court by a party with a legal interest;

(2) a promise by one party;

(3) actual reliance by another party;

(4) justifiable reliance by that same party;

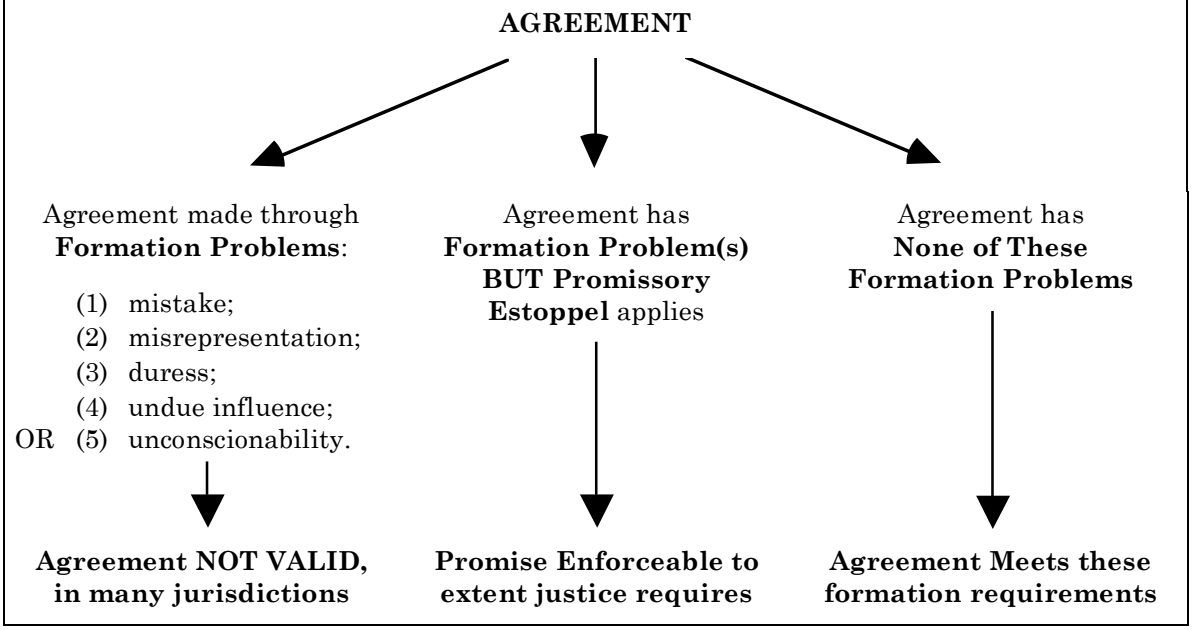
AND (5) unjust loss to the party who relied if the promise is not enforced.

Promissory estoppel is rare, since the last two requirements are hard to meet.

Some important situations where promissory estoppel may be used are where there is reliance on: promises before there is an acceptance; oral promises the law normally requires to be written; and promises not supported by consideration. Reliance on promises before acceptance may occur where a general contractor relies on bids (offers) of sub-contractors in bidding on a large contract. Reliance on promises without consideration might occur where a party promises to do something based on some past action, and the party receiving the promise justifiably relies on it. Suppose Vandy promised to give her moto to Vichda because Vichda had cared for Vandy for a year during which she was very ill, and Vichda justifiably relied by spending money to buy a new helmet and have the moto repaired. That promise might be enforced.

Where promissory estoppel applies, a promise is enforceable to the extent justice requires--not necessarily to the same extent as a normal contract promise. The most common remedy where promissory estoppel applies seems to be reliance damages, which compensate the injured party for what he lost in relying. In the moto example above, a court might compensate Vichda for what he lost in relying--what he spent to buy the helmet and have the moto repaired--rather than for the entire value of the moto.

Illustration: Where Agreements May Have Other Formation Problems



*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems") discusses other contract formation problems more fully.

1.4g Courts Use Various Methods to Help Them Interpret Contracts

Disputes may occur about what an agreement means. In these situations, parties often ask courts to interpret the contract. Sometimes courts must interpret contracts to determine if they are enforceable. More often, courts must decide the real meaning of enforceable contracts. A number of legal rules guide and limit how courts do that. This Section will discuss ten basic rules of contract interpretation; the evidence courts use to help them interpret; and what happens when a court cannot interpret a contract term.

Rule No. 1 -- Courts try to interpret contracts so that they are valid and reasonable, but they cannot interpret contracts any way they wish. So a court would interpret the term "full time" in an employment contract to comply with existing labor law. But a court cannot interpret an invalid contract to be valid.

Rule No. 2 -- Where the meaning of a disputed term is not clear, many courts say interpretation should be subjective (based on the parties' actual intentions), but if that is not possible, then it should be objective (based on what reasonable people would likely have intended). For example, many jurisdictions say that if the parties actually intended the same thing, a court should enforce that meaning. If it is not clear the parties intended the same thing, and only one party knew or should have known what the other party intended, then the court enforces the other party's meaning. If these steps fail, the court uses the objective rules of interpretation explained in the rest of

this Section. So if Chhon and Soubert made a tofu sale contract but now disagree about whether "tofu" meant firm or soft tofu, a court would first see if the parties actually meant the same thing; failing that, it would see if only one party knew or should have known the other party's meaning, such as where Chhon knew Soubert meant firm tofu; failing that, it would apply various objective rules to see what "tofu" meant, such as looking at the term's ordinary meaning and relevant trade practices.

Rule No. 3 -- Courts consider the whole contract. This requires the court to examine the whole agreement, which may define some of its own terms, and may consist of a number of different documents or statements.

Rule No. 4 -- Courts try to avoid inconsistency between terms. So if a chicken sale contract contains many references to "chickens," but also one to "fish," a court would likely interpret that one reference to "fish" as a mistake.

Rule No. 5 -- When terms in a contract conflict, courts value certain types of terms more highly than other types of terms. Generally, specific terms are stronger than general terms, and separately negotiated terms are stronger than pre-printed terms. So handwritten terms are stronger than typed ones, which are stronger than pre-printed "standard" terms.

Rule No. 6 -- If the meaning of a disputed term is not clear, courts consider the ordinary meaning that a reasonable person in the parties' situation would understand the term to have. To determine this, courts might consult standard reference works such as dictionaries and technical manuals.

Rule No. 7 -- If the meaning of a term is disputed, courts consider the main purposes of the parties when they made the contract. These might be based on the actual contract terms, the type of contract, or other evidence.

Rule No. 8 -- If the meaning of a term is disputed, courts consider all the surrounding circumstances, particularly the course of performance, prior dealings, and trade usages. The most important is the course of performance, which is conduct of the parties after they made the contract indicating they had a particular understanding of its terms. An example might be a party's failure to object to a performance, which might suggest that it matched his understanding of the contract. Second most important is any prior dealings between the parties, before the contract was made. Third most important is any trade usages which relate to the type of contract the parties made.

Rule No. 9 -- Disputed terms are interpreted against the party who drafted the contract, if that is reasonable. In adhesion contracts, where one party drafts the contract, many courts will not enforce terms that a reasonable other party would not expect to be in the contract, and to which the other party would not have agreed if he had known--even if the meaning of those terms is clear! An example might be an improper exculpatory clause.

Rule No. 10 -- Courts in many jurisdictions interpret contracts to contain specific terms that the law requires or allows, if the parties omitted those terms. Many jurisdictions require courts to consider certain specific terms, such as the duty of good faith and fair dealing, to be part of contracts. The duty of good faith and fair dealing basically requires a contract party to be honest and not seek unfair advantage (good faith), and to follow reasonable standards of fair conduct (fair dealing). An example of a violation of this duty would be intentionally giving an improper contract performance.

Many jurisdictions also allow courts to supply certain terms in order to resolve disputes, such as "gap-fillers" for sale of goods contracts. Courts cannot supply essential terms, such as identity or quantity terms in such contracts. But many will supply certain missing terms, such as: a reasonable price; that the buyer pays cash at the time and place of delivery; and that the seller delivers all the goods in a reasonable time, usually at the seller's place of business, or at his residence.

*** ***CASE STUDY 18***

FACTS Vin and Nguon agree that Vin will "buy two small Model X-3 notebooks" from Nguon but state no other terms. Nguon says they have no contract.

QUESTION OF LAW Do Vin and Nguon have a contract?

DECISION Yes, in many jurisdictions. Many courts will supply certain missing terms to such sale of goods agreements and enforce them.

Many courts will supply certain missing terms to sale of goods agreements. Here, Vin agreed to buy two notebooks, but the parties said nothing about price, payment or delivery. Many courts would imply: a reasonable price; that the buyer pays cash at the time and place of delivery; and that the seller delivers all the goods in a reasonable time, usually at the seller's place of business, or otherwise at his residence. So the contract would require Vin to pay a reasonable price in cash at the time of delivery, and Nguon to deliver both notebooks within a reasonable time, probably at his place of business.

In order to interpret contracts, courts use various types of evidence. In general, this can include documents other than the contract, testimony from the parties or other witnesses, and reference materials.

However, many common law jurisdictions use the parol evidence rule to limit the evidence courts can use with regard to written contracts. This rule says that where a final writing contains contract terms of the parties, a court cannot generally allow evidence of statements made by the parties prior to that writing to contradict or add to the terms of a complete writing, or contradict the terms of an incomplete writing. So if the contract in Case Study

18 was in a final, complete writing, a court could not allow evidence of prior statements to add a price term, or change the quantity term. But this rule does not apply: where there is no writing; where the writing is not final; where prior statements are presented to help a court determine whether a writing is complete, or understand the meaning of the terms in the writing; to evidence of statements made after the time of the writing; or to evidence used to show the agreement is not valid. So it would not apply to statements used to explain exactly which "notebooks" Vin and Nguon meant, or to show that Vin made the contract under duress.

When a court cannot interpret a disputed agreement term, the result often depends on whether the term is material. When a material term cannot be interpreted, the agreement is probably unenforceable. In Case Study 18, if the parties had tried to set a price--a material term--but their term could not be interpreted, the agreement probably could not be enforced. When a non-material term cannot be interpreted, the agreement might be enforceable without the term. In that case, the court might be able to sever the term.



Illustration: How Many Courts Interpret Contracts

AGREEMENT WITH INTERPRETATION PROBLEM



(1) Interpret to be valid and reasonable if possible;

(2) Use subjective, then objective interpretation;

(3) Consider whole agreement;

(4) Try to avoid inconsistency between terms;

(5) Value certain terms more highly;

(6) Consider ordinary meaning of agreement;

(7) Consider main purposes of parties;

(8) Consider surrounding circumstances (course of performance, prior dealings, trade usages);

(9) Interpret against drafter if reasonable;

(10) Interpret to contain certain terms the law requires or allows.

- Parol Evidence Rule (common law)--generally bars use of evidence of prior statements to contradict or add to the terms of a complete final writing, or to contradict the terms of an incomplete final writing.

Still cannot interpret disputed term?



Non-Material Term



Perhaps Enforce Agreement Without Term

Material Term



Probably Cannot Enforce Agreement

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts") discusses interpretation of contracts more fully.

1.4h How Courts Analyze Performance of Contracts and Discharge of Duties

In many cases, a contract is enforceable, and its meaning can be determined. But courts must often resolve disputes about whether parties have performed the contract properly, and whether any duties remain to be performed.

Contract duties do not end until they have been discharged--ended. Whether the duties have become due for performance, and whether they have been discharged, may depend on the nature of performances the contract requires. That may depend on whether any conditions to performance have been fulfilled or excused, and whether promises in the contract have been

properly performed. Contract duties do not become due until any conditions on which they depend are fulfilled or excused. Conditions may be fulfilled by occurrence or performance, and excused in various ways. How this occurs may vary in particular situations. Duties may be finally discharged by performance, breach, or other events related directly to performance; by a later agreement or statement of the parties; or by operation of law. This Section discusses these complex but important issues.

Nature of Performances the Contract Requires

Whether contract duties have been discharged may require analysis of the nature of performances the contract requires. Two important parts of this analysis are promises and conditions.

Promises are statements that a party will perform a duty when performance is due. Promises create contract duties. An unexcused failure to perform a contract promise when it is due is a breach. A breach gives the injured party the right to ask a court for a remedy.

Conditions are events which are not certain to occur but which must occur or be excused in order for a contract duty to become due or terminate. Conditions may be performances of the parties, or other events. If conditions are not fulfilled or excused, then any duties which depend on the conditions do not become due for performance. For example, suppose Navy and Ham agree that Ham will provide a shirt to Navy, and Navy will pay 10,000 riels for the shirt, but that Navy's duty to pay becomes due "only if Ham first delivers the shirt to Navy." In this case, Ham promised to make a shirt, and Navy promised to pay for it. However, the contract also has a condition: the delivery of the shirt. Navy's duty to pay does not become due unless Ham delivers the shirt to her.

Conditions can be classified by when they may occur. Conditions precedent are those that must occur before a duty of performance becomes due. An example appears in the shirt contract above.

Conditions subsequent are those that terminate a duty of performance that is already due. These are rare. An example would be when an insurer's duty to pay a policyholder's claim becomes due, but the insurer does not pay. The insurance contract may provide that the insurer's duty to pay will terminate after a certain time if the policyholder fails to bring a lawsuit about the claim within that time. The policyholder's failure to sue is the condition subsequent. Under the insurance contract, the insurer's duty to pay was due, but it terminated because the policyholder failed to sue within the time specified in the contract.

Finally, conditions concurrent are those that must occur roughly simultaneously in order for each party's duty to perform to become due. The law implies these where the performances of the parties can occur at roughly

the same time, as in most sale of goods contracts. In the shirt example above, if the parties had not included a condition in their contract, each party's duty to perform probably would have depended on the other party's performance (or tender of performance).

Conditions can also be classified by how they are created. Express conditions are those created by words in the contract. Courts require that these be completely fulfilled (or excused) in order for the duties that depend on them to become due. An example appeared in the shirt contract above.

Implied-in-fact conditions are those courts find exist because of the apparent intentions of the parties to the contract, even though they are not expressly stated. These may occur where one party must do something in order for the other party to be able to perform. If the shirt contract above required Ham to deliver a shirt "in a color of Navy's choice," Navy would obviously have to pick a color in order for Ham to perform! So that act of choosing would be an implied-in-fact condition to Ham's duty to provide the shirt to Navy. These conditions must be completely fulfilled (or excused) in order for duties to become due.

Implied-in-law conditions are those courts find exist in contracts in order to achieve justice in certain types of situations, unless the parties expressed a different idea. In particular:

(1) if the parties' performances can occur roughly at the same time, each party's performance is generally a condition concurrent to the other party's duty to perform;

(2) if one party's duty requires a period of time to perform and the other party's duty does not, the longer performance is generally a condition precedent to the other party's duty; and

(3) if the performance of one party's duty is to occur earlier than the performance of the other party's duty, the earlier performance is a condition precedent to the later duty.

Implied-in-law conditions can be fulfilled by substantial performance, which occurs where there is only a minor breach. So if the law implied conditions concurrent in the shirt contract above, substantial performance by Ham or Navy would cause the other party's duty to become due.

How Conditions Are Fulfilled or Excused

A duty does not become due for performance until any conditions on which it depends are fulfilled or excused. Conditions are fulfilled by occurrence or performance. Conditions may be excused in certain situations where it would be unfair to expect them to be fulfilled.

A condition is fulfilled if it occurs. Suppose a contract duty becomes due if it rains, and it does rain. The condition has occurred. So it is fulfilled.

A condition is fulfilled by complete performance, where that condition is also a performance promised in the contract. So if Ham delivers the shirt exactly as required in the contract above, the condition precedent to Navy's duty to pay is fulfilled, and Navy's duty becomes due for performance.

An implied-in-law condition is fulfilled by substantial performance (or complete performance). A party has substantially performed if he has committed only a minor breach--not a material (important) breach. As noted above, a breach is a failure to perform a contract promise without a legal excuse. Any breach gives the injured party the right to ask a court for a remedy, such as money damages.

To determine if there has been substantial performance--and only a minor breach--many courts in the United States consider the following factors:

(1) Has the party harmed received the benefit he reasonably expected from the contract?

(2) Can the party harmed be adequately compensated for the breach by money damages?

(3) Will the breaching party suffer forfeiture or hardship if the breach is considered material?

(4) Will the breaching party fix or "cure" his failure to perform, and perform fully?

(5) Has the breaching party followed the standards of good faith and fair dealing?

The more positive the answers to these questions are, the more likely it is that substantial performance has occurred. A "forfeiture" is basically a loss of something to another person with no adequate legal remedy for the person suffering the loss. It can occur where one contract party provides some performance to another party, but the first party cannot recover under the contract for his performance, because a condition to the other party's duty to perform has failed, and that party's duty has not become due.

Since every case is different, each factor above must be closely examined to see if a breach is material or minor in any particular situation. However, potential examples of minor breaches include small delays in performance where time is not crucial, or minor problems in the quality of performance. Potential examples of material breaches include delivering a completely wrong kind of goods, or not doing most of the work required in a labor contract. Delay in performance will not generally be a material breach unless it significantly deprives the other party of the benefit of the contract.

*** ***CASE STUDY 19***

FACTS San and Chanto make a contract in which they agree that San will build a new shophouse for Chanto and his family, and complete work no later than December 31. However, San is two days late in finishing. Chanto says his duty to pay for the work is not due. San asks the court for help.

QUESTION OF LAW Is Chanto's duty to pay for San's work due?

DECISION Probably. San has probably substantially performed--and so caused Chanto's duty to pay to become due--because this small delay in completing the shophouse is probably only a minor breach.

Implied-in-law conditions can be fulfilled by substantial performance. In this case, San had a contract to build a shophouse for Chanto. Many courts would say that San's completion of the shophouse was an implied-in-law condition precedent to Chanto's duty to pay for it, since the building would take time to complete and the payment probably would not. But San was two days late.

This was probably a minor breach. Chanto received the benefit he reasonably expected--a new shophouse basically on time. There is no evidence that money damages are inadequate to compensate Chanto for the breach, or that San did not follow standards of good faith and fair dealing. And San may suffer a forfeiture if the breach is considered material. He could not get the contract price (though perhaps he could get restitution) for his work if Chanto's duty to pay did not become due. On the other hand, this breach cannot be cured, since the due date has passed. But on the whole, a court would likely say this breach was minor. Chanto's duty to pay would become due, though he could get a remedy for San's breach.

A condition may be excused by an anticipatory repudiation by the party whose duty depends on the condition. An anticipatory repudiation is basically a statement by one contract party to another contract party that clearly shows the first party does not intend to perform a contract duty in the future when it is due. An example would be if Ham said to Navy: "I will not deliver the shirt." But if Ham merely said something like "I am not sure about the contract," that would not be enough to be an anticipatory repudiation. In addition to excusing conditions, an anticipatory repudiation also gives the other party the right to stop performance, treat the repudiation as a material breach and immediately ask a court for a remedy, and other options. A repudiation can be retracted by the repudiating party up until the time for his performance, unless the other party indicates that he considers the repudiation final, or detrimentally relies on it. Detrimental reliance might occur where the other party makes a new contract with a different party to substitute for the original contract.

A condition may also be excused by the prospective inability or unwillingness to perform of the party whose duty depends on the condition. This occurs where circumstances provide a reason to believe that it is likely that a party will be unable or unwilling to perform a contract duty. An example would be if Ham told Navy: "I doubt very much that I can deliver the shirt." One difference between this and anticipatory repudiation is in how clear it is that the party will not perform. Another difference is that there need not be any statement for prospective inability or unwillingness to exist. For example, Navy could become aware some other way that Ham will likely not be able to supply the shirt. Where there is a prospective inability or unwillingness, the other party can stop his own performance. Some courts allow a party to treat this problem as a material breach and immediately seek a remedy. Others allow a party to seek adequate assurances from the party whose performance is in doubt. If the seeking party does not receive such assurances, the prospective inability or unwillingness actually becomes an anticipatory repudiation. A party whose performance is in doubt can fix or "retract" this problem by a communication to the other party showing his new ability or willingness, unless the other party has detrimentally relied.

A condition may be excused by the failure or occurrence of a prior condition. If one condition depends on the occurrence of a prior condition, and the earlier condition fails, then the later condition may be excused. This might happen with implied-in-fact conditions, such as if Ham's supplying of the shirt (a condition) depended on Navy's choosing the shirt she wanted (another condition). If Navy failed to choose, it would excuse the condition that was Ham's delivery of the shirt, and Navy's duty to pay would become due. If Navy performed and chose the shirt, then Ham's duty to provide the shirt would also become due.

A condition may be excused by improper rejection of a tender of performance. A tender of performance is basically a party's offer to perform his existing contract duties, with the present ability to do so. This kind of rejection might occur if Ham presented the correct shirt to Navy according to the contract, but Navy refused it without any good reason.

A condition may be excused by wrongful prevention or hindrance by the party whose duty depends on the condition. This occurs where such a party's wrongful actions prevent a condition's occurrence or make it very difficult. Such conduct might also be a material breach. Whether conduct is wrongful depends on whether the other party assumed the risk that it would occur. Buyers and sellers of goods generally assume the risk that a change in the market supply or price will hinder their performance--but not that the other party will knowingly prevent it. Ham would probably assume the risk that shirts would become more difficult or expensive to supply, even if Navy caused this market change. But he probably would not assume the risk that Navy would buy every available shirt, knowing that would prevent Ham's performance.

A condition may be excused by waiver by the party whose duty depends on the condition. A waiver of a condition basically occurs where a party indicates through words or conduct that he will not insist that a condition occur in order for his contract duty to become due. Waiving a condition does not generally affect the promises under a contract. So the waiving party still generally has the right to seek a remedy for any breach by the other party, unless the waiver is part of a binding contract modification.

A waiver can occur before a condition is scheduled to occur, or after a condition fails to occur. Before a condition is to occur, it appears that a party whose duty depends on the condition generally can waive the right to the benefit of that condition. Suppose Tech had a contract to do some work for Chhay. Chhay could waive the implied-in-law condition precedent which is Tech's substantial performance of the work, a condition which would be required to be fulfilled in order for Chhay's duty to pay to become due. Both parties would owe basically the same duties as they did before, but Tech would not be required to perform first in order for Chhay's duty to pay to become due. One exception to this general rule is that most material express conditions cannot be waived in common law jurisdictions. This exception may not apply where promissory estoppel or a special statute such as one governing the sale of goods applies.

A party waiving before a condition is to occur can generally retract his waiver until the other party justifiably relies on it. So Chhay could retract his waiver, unless Tech had justifiably relied on the waiver. That might occur if Chhay promised to pay Tech at some time before Tech would finish work, and Tech made other commitments to use the payment at that earlier time, in reliance on Chhay's promise.

After a condition fails to occur, a party whose duty depends on the occurrence of the condition may elect to continue with the contract despite the failure of the condition. The party can do this expressly by saying he is, or impliedly by continuing his own performance or accepting benefits under the contract. A waiving party generally cannot retract this kind of waiver. Suppose Tech fails to do some of the work required by his contract with Chhay, but Chhay pays Tech anyway after Tech promises to do the work the next day. Chhay has waived the benefit of the implied condition precedent to his duty to pay for the work. Of course, Chhay can still seek a remedy for the breach by Tech.

A condition may also be excused by estoppel. Estoppel occurs where it would be unfair to allow a party to make a certain legal claim because of inconsistent prior actions by that party. So if Navy wrongly prevented Ham from delivering the shirt their contract required, some courts might say she was estopped from claiming Ham did not fulfill the condition to her duty.

Conditions may be excused by impossibility of performance. This may occur where the condition does not involve a material part of the contract and

a forfeiture could result from the failure of the condition. An example might be where an express condition of approval of performance becomes impossible. This could occur where a non-party who is to give the approval dies, and the party whose performance is being evaluated may suffer a forfeiture if the condition is not excused.

The failure of a condition to occur may not affect the whole contract if the contract is severable. Contracts may be "severable" or "entire" (not severable). If a contract is severable, the failure of a condition as to one part does not affect the performance of the other parts (unless the failure is also some other problem, like a material breach). In many jurisdictions, contracts are severable if performance by each party can be divided into more than one part, the number of parts due from each party is the same, and the performance of each part by one party appears to be the agreed exchange for the performance of the corresponding part by the other party. Ham and Navy's one shirt contract above would not be severable. But many employment contracts are severable by pay periods. In those cases, a failure of an employee to fulfill a condition as to one period would not affect the employer's duty to pay for other periods (unless the failure was also some other problem, such as a material breach).

Conditions of approval are subject to certain limits. Conditions of approval are express conditions that say one party's duty depends on that party's approval of the other party's performance, or the approval of a person who is not a contract party. The law limits the power of the evaluating party to cause the condition to fail. If these limits are not followed, then the condition is excused.

Where there is a condition of approval by a party to the contract, common law jurisdictions say the party cannot have complete discretion to disapprove, or else his contract promise is illusory and there is no consideration. Assuming there is an enforceable contract, many jurisdictions say that such conditions of approval that involve matters of aesthetics and taste will fail if the evaluator honestly disapproves of the performance. But if they involve matters of practical standards that can be measured more objectively, they will fail only if the evaluating party is reasonable in rejecting the performance. So if Navy's duty to pay depended on whether she approved the shirt Ham was to supply to her, and she did not approve, a court would first have to decide whether the approval was more about aesthetics or practical matters, since clothing has both aesthetic and practical elements. If the condition was aesthetic, Navy's disapproval would have to be honest in order to cause the condition to fail. If the condition was practical, Navy's disapproval would have to be reasonable.

Where there is a condition of approval by a non-party, many courts first ask whether there will be a forfeiture if the non-party disapproves. A forfeiture could occur if the party whose performance is being evaluated cannot be paid under the contract for all his work unless the condition is

fulfilled or excused. If there will be no forfeiture, it appears that rejection will generally cause the condition to fail unless fraud or collusion was involved. If there will be a forfeiture, there are two possibilities. If the condition involves a matter of aesthetics and the parties chose a special non-party to analyze the performance (not one chosen from a group of many qualified evaluators), then the condition will fail if the evaluator honestly disapproves. In all other cases involving forfeitures, courts examine four factors to see whether disapproval will cause a condition to fail: (1) the size of the potential forfeiture of the party whose performance is being evaluated (the larger this is, the less likely the condition will fail); (2) the nature of the performance (aesthetic or practical); (3) whether the rejection was reasonable (the less reasonable, the less likely the condition will fail); and (4) the expertise of the evaluating non-party (evaluators with more expertise get more discretion).

Performance of Duties in Particular Situations

The rules above do not apply exactly the same way in all situations. For example, they vary in some jurisdictions with regard to construction contracts, sale of goods contracts, and the duty of good faith and fair dealing.

In construction contracts, there is a great potential for forfeiture where a builder performs substantially but not completely, and the contract seems to have an express condition requiring complete performance. If possible, courts interpret such a condition to be implied-in-law, so that substantial performance will fulfill the condition and there will be no forfeiture. But if that interpretation is not possible, some courts may refuse to enforce the express condition, and instead apply the substantial performance rule.

Special performance rules may also apply to sale of goods contracts. Two key areas where such rules exist are with regard to waiver and tender of performance. Some common law statutes, such as the Uniform Commercial Code ("UCC") in the United States, allow parties to make good faith modifications of sale of goods contracts even if there is no new consideration. So such parties can waive the right to the benefits of even material express conditions and promises.

The UCC also provides special rules about tender of performance in sale of goods contracts. These depend on whether the contract is a "single lot" or "installment" contract. Basically, installment contracts are those that require or authorize the delivery of goods in separate lots. All other contracts are single lot contracts. The general UCC rule for single lot contracts is that the buyer has the right to reject a tender of goods if that tender fails in any way to follow the terms of the contract. However, there are so many limits on this general rule--such as the seller's right to "cure" the non-conforming tender in certain situations--that the practical result seems to be that courts often do not allow buyers to reject goods unless the non-conformity is serious. For example, suppose a contract required Kosal to deliver some photographic film to Samy, but Kosal delivered the wrong kind of film and Samy rejected his tender.

Kosal could still cure this non-conforming tender up until the time for delivery expired, and even for a reasonable time afterwards, if Kosal reasonably thought his non-conforming tender would be acceptable to Samy. The general UCC rule for installment contracts is that the buyer can reject a non-conforming tender of an installment only if the non-conformity substantially reduces the value of the installment and it cannot be cured.

Many jurisdictions say that the duty of good faith and fair dealing is present in every contract. This duty applies in the performance and enforcement of contracts, and in some situations even at the negotiation stage. Examples of conduct that may violate this duty include intentionally giving an imperfect performance, and interfering with the other party's performance or ability to benefit from the contract.

How Contract Duties May Be Discharged

Duties may be discharged by events related directly to performance, a later agreement or statement of the parties, or by operation of law. These possibilities are explained below.

Duties may be discharged by performance, breach, or other events related directly to the performance of the contract. These potential events are discussed below.

First, complete performance discharges the contract duties of the performing party. This rule does not apply to obligations the party may have--even after his own performance--not to violate general legal duties he owes the other party, such as the duty of good faith and fair dealing.

A breach may discharge the contract duties of the innocent party. In general, a breach that causes a condition to fail--and so causes a duty not to become due--may discharge duties. The most common way for this to occur is where there is a material breach. Where that occurs, the non-breaching party basically has three options: (1) end the contract and cause only his own duties to be discharged, then sue for breach; (2) unilaterally rescind the contract and cause all duties in the contract to be discharged; or (3) continue with the contract, which would generally result in a waiver of the benefit of the condition. For instance, in the photographic film example above, if Kosal materially breached by failing to deliver the film as required, Samy could simply end the contract and cause her own duties to be discharged, then ask a court for a remedy for Kosal's breach; rescind the contract and end all duties; or continue with the contract, hoping Kosal would perform. In general, a party can also cure his breach if he can fix the problem within a reasonable or appropriate time. Samy would have to allow Kosal a reasonable opportunity to do that.

An anticipatory repudiation may also discharge the contract duties of the innocent party. This is because it basically gives the non-repudiating party the same options discussed above as to a material breach.

An improper rejection of a tender of performance may discharge the contract duties of the tendering party. That occurs where the party who improperly rejected fails to cure his improper rejection.

The occurrence of a condition subsequent may discharge contract duties. This is because that occurrence actually terminates a legal duty that is already due for performance.

Finally, the avoidance of a voidable contract may discharge contract duties. This could occur because of a number of formation problems.

Contract duties may be discharged by a later agreement or later statement of the parties. That can occur through a mutual rescission, release, substitute contract, accord and satisfaction, novation, or account stated.

A mutual rescission occurs where contract parties agree to cancel their contract, and so discharge all the duties under that contract. A mutual rescission can be express or implied. For instance, in the photographic film example above, Kosal and Samy could mutually agree to cancel their contract impliedly, perhaps by making a new contract that had the effect of changing the duties under the old one. Common law jurisdictions generally require consideration in order for a mutual rescission to be enforceable. A mutual rescission cannot affect the contract rights of third parties if those rights are "vested," which basically means if they are the present property of the holder of the right.

A release may also discharge contract duties. A release is a signed document in which a party discharges duties owed to him. So Samy could discharge Kosal's contract duties by signing a statement saying she was discharging them. It seems that some common law jurisdictions require consideration for releases, but others do not.

A substitute contract may discharge contract duties. A substitute contract is a new contract between parties that immediately discharges the duties under an old contract between the parties. As with releases, it seems that some common law jurisdictions require consideration for substitute contracts, while others do not.

An accord and satisfaction may discharge contract duties. An accord and satisfaction occurs where the parties to an existing contract make a new contract that substitutes a different duty for a duty owed under the old contract (the "accord"), and then that new duty is performed as required by the new contract (the "satisfaction"). An accord does not immediately discharge the duty under the old contract, but only suspends the duty until satisfaction

occurs. Some common law jurisdictions require consideration in order for accords to be valid.

A novation may discharge contract duties. A novation is an agreement among contract parties and a new party to substitute the new party for one of the original parties and immediately discharge the duties under the original contract. This results in a new contract between the new party and one of the parties to the old contract.

An account stated may discharge contract duties. An account stated is an agreement between a creditor and a debtor that a particular sum is what the debtor owes the creditor because of prior transactions. The account stated immediately discharges the duties from the prior transactions.

Finally, contract duties may be discharged by operation of law. That can happen through impossibility or impracticability, frustration of purpose, bankruptcy, a final court judgment or arbitration award, or the passing of time set by a statute of limitations.

Impossibility or impracticability of the performance of a contract may discharge contract duties. Many jurisdictions say this can occur where: (1) some event causes performance of a contract to become impossible or highly impracticable; (2) neither contract party caused the event; and (3) neither party assumed the risk of the event. In order to be "impracticable," the increased difficulty a party encounters in performing a contract must be extreme. A party may assume the risk in the contract, or because the law says so. For example, parties generally assume the risk that market prices and expenses will change substantially, but not the risk that performance will unexpectedly become extremely difficult. The effect of impracticability is that all duties under a contract are discharged. Some important situations where impracticability may occur are where performance of the contract becomes illegal; a party or other person needed for the performance of the contract dies or becomes incapacitated; the specific subject matter of the contract is destroyed; or a natural or human disaster makes performance of the contract extremely difficult or expensive. Potential examples of such disasters include crop failures, earthquakes, floods, wars and trade embargoes.

Frustration of purpose may also discharge contract duties. Frustration of purpose occurs where both contract parties understood the main purpose of the contract; some event has made contract performance almost or totally valueless to one party; that party did not cause the event; and the parties did not expect the event to occur. This discharges all contract duties. An example might be where a party rented space for a short time in order to celebrate or observe a particular event, and then the event was canceled.

Bankruptcy proceedings may also discharge contract duties. When the liability of a person under a contract is resolved in bankruptcy proceedings,

the duties under that contract are generally discharged, and the only duties remaining are those created in the bankruptcy proceeding.

Sometimes a contract dispute is resolved by a final court judgment or proper arbitration award. In that situation, the duties under the original contract are generally discharged and "merged" into the judgment or award.

Finally, the passing of the time set by a statute of limitations may discharge contract duties. In some jurisdictions, this only bars a lawsuit about the contract duties, provided the issue is properly raised in court.

*** ***CASE STUDY 20***

FACTS Thy makes a contract promise to ship 100 boxes of cassette tapes by road to Vey, who lives three hundred kilometers away, within five days. The tapes will not be useful to Vey after five days. Planes do not fly to Vey's town. Before Thy can ship the tapes, unexpectedly severe flooding makes it impossible for the tapes to be delivered by land for at least several weeks.

QUESTION OF LAW Have the duties in this contract been discharged?

DECISION Probably. The duties under this contract have probably been discharged because Thy's shipment to Vey of the tapes has probably become legally impossible, or at least impracticable, due to the severe flooding.

Contract duties are discharged where an event causes performance to become impossible or highly impracticable, neither party caused the event, and neither party assumed the risk of the event. In this case, Thy agreed to ship cassette tapes to Vey by road within five days. But unexpectedly severe flooding made it impossible to deliver the tapes for at least several weeks, long after the tapes would no longer be useful to Vey. Thy's performance has become impossible or at least impracticable, neither party expected this flooding, and it does not seem that either party assumed the risk that it would occur. So the duties in this contract have probably been discharged.



Illustration: How Many Courts Analyze Contract Performance and Discharge of Duties

IS CONTRACT DUTY DUE?

Have Any Conditions Been:

(1) **Fulfilled by**:
- (a) occurrence;
- (b) complete performance; or
- (c) substantial performance (implied-in-law only); OR

(2) **Excused by**:
- (a) anticipatory repudiation;
- (b) prospective inability or unwillingness to perform;
- (c) failure or occurrence of a prior condition;
- (d) improper rejection of a tender of performance;
- (e) wrongful prevention or hindrance;
- (f) waiver or estoppel; or
- (g) impossibility of performance?

HAS DUTY BEEN DISCHARGED?

(1) **By Performance, Breach, or Other Events Related Directly to Performance**:
- (a) complete performance;
- (b) breach;
- (c) anticipatory repudiation;
- (d) improper rejection of tender of performance;
- (e) occurrence of condition subsequent; or
- (f) avoidance of a voidable contract; OR

(2) **By Later Agreement or Statement of Parties**:
- (a) mutual rescission;
- (b) release;
- (c) substitute contract;
- (d) accord and satisfaction;
- (e) novation; or
- (f) account stated; OR

(3) **By Operation of Law**:
- (a) impossibility or impracticability of performance;
- (b) frustration of purpose;
- (c) bankruptcy proceedings;
- (d) final court judgment or arbitration award;
- (e) statute of limitations?

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties") discusses more fully how courts analyze performance and discharge of duties.

1.4i Courts May Order or Allow Various Remedies Where There Is a Contract Dispute

If there is a contract dispute, and contract duties have not been properly discharged, various kinds of remedies may be available. The two main groups of remedies courts may order are money damages and non-monetary remedies. One important limit on such potential remedies is that courts generally have no power to impose criminal penalties in contract disputes. Another key limit is that the law often cannot fully compensate the parties for the harm caused by a contract problem and dispute. So it is often wise to consider alternative dispute resolution (ADR) in order to try to minimize this problem.

Perhaps the most important type of money damages many courts will order a breaching party to pay an injured party is expectation damages. These are damages that try to place the injured party as close as possible to the position he would have occupied if the parties had fully performed the contract. This usually comes closest to giving the injured party the "benefit of his bargain." To calculate expectation damages, many courts determine the value in money of the additional benefits the injured party would have received if the breaching party had fully performed, then subtract the value of what the injured party saved (if any) because he was not required to perform his own duties. The resulting amount is the expectation damages.

*** ***CASE STUDY 21***

FACTS Vanarong and Mouly make a contract in which Mouly agrees to supply a certain number of palm trees to Vanarong for his new hotel for $1,000. Mouly supplies the trees according to the contract, but Vanarong pays only $800, telling Mouly he will get the rest of the money to him soon. But Vanarong never pays. So Mouly asks the court for expectation damages.

QUESTION OF LAW What are Mouly's expectation damages in this case?

DECISION Mouly's expectation damages are $200. This is because that is the amount of the additional benefits Mouly expected to receive ($200) minus the amount Mouly saved by not having to perform his own duties ($0).

Many jurisdictions calculate expectation damages by determining the value of the additional benefits the injured party expected, then subtracting what that party saved by not having to perform his own duties. In this case, Vanarong breached his obligation to pay Mouly for palm trees by paying only $800, instead of the $1,000 the contract required. Mouly's expectation damages would be the value of the additional benefits he expected to receive ($200) minus what he saved by not having to perform ($0, since he did perform his own duties). $200 - 0 = $200. So Mouly's expectation damages are $200.

A court may order reliance damages where expectation damages are not appropriate. Reliance damages try to place a party injured by a

contract breach or failure to perform a promise as close as possible to the position he occupied before the contract or promise was made. Suppose Chan and Sastra make a contract in which Chan agrees to build Sastra a $100,000 building, Chan spends $10,000 on the construction, then Sastra repudiates. Chan's expectation damages might be hard to prove. So he might ask a court to award him what he spent in reliance on the contract--$10,000--which would basically put him in the position he occupied before the contract was made.

A court might order a party to pay restitution damages where neither expectation nor reliance damages are appropriate. Restitution damages try to compensate a party for the value of the benefit he has given to another party, in order to avoid unjust enrichment. Restitution damages are likely to be awarded where there was no valid contract, but one party provided some benefit to another, and there would be unjust enrichment if the other party was allowed to keep that benefit. Such damages may also be awarded where there was a valid contract, but there was a bilateral or unilateral rescission; duties were discharged by impracticability or frustration of purpose; an injured party can recover more by restitution than by using other measures of damages; or a breaching party wishes to recover what he has provided to the other party. Most of these are quasi-contract situations.

For example, restitution might be awarded where a party provides urgently needed health care to an unconscious accident victim. There would be no valid contract, since an unconscious person cannot make one, but many courts consider it unjust to allow the victim to keep the benefit of the health care without compensating the person who provided it. Another example might be if the breaching party Sastra in the construction example above had actually provided Chan with some benefit prior to Sastra's breach. Sastra might be able to get restitution, once the court took account of the damages caused by his breach.

In certain situations, courts may order a party to pay other damages or monetary awards. Courts may order a party to pay stipulated damages (liquidated damages) where the contract itself describes the damages to be paid in the event of a breach. In many common law jurisdictions, such clauses are enforceable, as long as they are reasonable compared to the damages the parties might have expected when they made the contract or the damages that actually resulted from the breach. So if Chan and Sastra's $100,000 construction contract had a stipulated damages clause saying Chan had to pay Sastra $1,000,000 for each day Sastra was late in finishing the building, common law courts might find that clause unreasonable, and not enforce it.

Courts might order a party to pay nominal damages where a breach has occurred but no real harm is proved. Nominal damages are a small sum awarded to show that a legal wrong has occurred.

In addition, courts may order a party to pay interest in contract disputes. Most jurisdictions award parties interest at a certain rate on

the amount of a court judgment from the time of the judgment until it is paid. Many jurisdictions also award pre-judgment interest on the amount of damages caused by a contract breach from the time of the breach, if the amount of these damages was certain enough at the time of the breach.

However, courts resolving contract disputes generally do not order parties to pay punitive damages. Courts award punitive damages to punish a party who has committed a civil wrong, and deter him and others from committing such wrongs in the future. Courts do not generally believe contract breaches are serious enough wrongs to justify such damages. But such damages might be awarded if a party's conduct in breaching a contract is also a tort, such as fraud or bad faith. A bad faith breach of contract may be a tort in limited cases where a contract party's breach is especially malicious or unjustifiable--such as where a party denies without any legitimate reason that a contract even exists!

There are several important general limits on the damages parties can recover in contract disputes. These are that parties can recover only damages they prove with reasonable certainty, that they could have reasonably foreseen, and that they could not have reasonably avoided.

First, parties can generally recover only damages that they prove with reasonable certainty. This rule is especially important where courts must decide whether expectation damages are too uncertain. That might be a problem in certain types of cases, such as those involving new businesses.

Second, parties can generally recover only damages that a reasonable person could have foreseen. In applying this rule, many jurisdictions say that parties may recover two types of contract damages: (1) those that are a natural and usual (foreseeable) result of the type of breach involved (general damages); and (2) those that occur because of special circumstances, which can be recovered only if the breaching party actually knew about the special circumstances (consequential damages). Suppose Chan contracted to build Sastra a factory, but breached by failing to complete the building on time. Sastra could recover general damages, such as his normal losses because he could not use the building for the time Chan was late in delivering it. But suppose Sastra also had a manufacturing contract with a stipulated damages clause. Chan's late delivery of the building caused Sastra to breach this manufacturing contract, and to owe a large amount in stipulated damages. These would be consequential damages, since they occurred because of special circumstances: the manufacturing contract with the stipulated damages clause. So Sastra could recover these damages from Chan only if Chan actually knew about Sastra's manufacturing contract.

Third, parties cannot recover damages that they could reasonably have avoided. This means that, when a breach occurs, the injured party should stop his own performance if continuing would increase his damages. It may also mean that a party should use reasonable efforts to find a

substitute performance. In the construction example above, if Sastra repudiated after Chan had started building, Chan would have to decide whether he could best avoid further damages by stopping his work, or completing the building.

Courts may also order or allow various non-monetary remedies. First, courts may order specific performance of the contract, which is to order that a breaching party actually perform the contract. It appears that courts often order specific performance in civil law jurisdictions. However, in many common law jurisdictions, courts prefer to order money damages. Such common law courts order specific performance only where money damages are not adequate to compensate the injured party, and the court believes it can adequately enforce the order. This occurs primarily were the subject matter of the contract is unique, as with contracts for the sale of land or unique goods like art. So this remedy would probably not be available in common law jurisdictions for contracts for common goods such as rice. Nor would it generally be available for construction or personal services contracts, since it might be difficult for a court to enforce the order in those situations.

In addition, courts may order or allow rescission of the contract. This is basically the cancellation of the contract, by one or both parties. Restitution is often available in this situation.

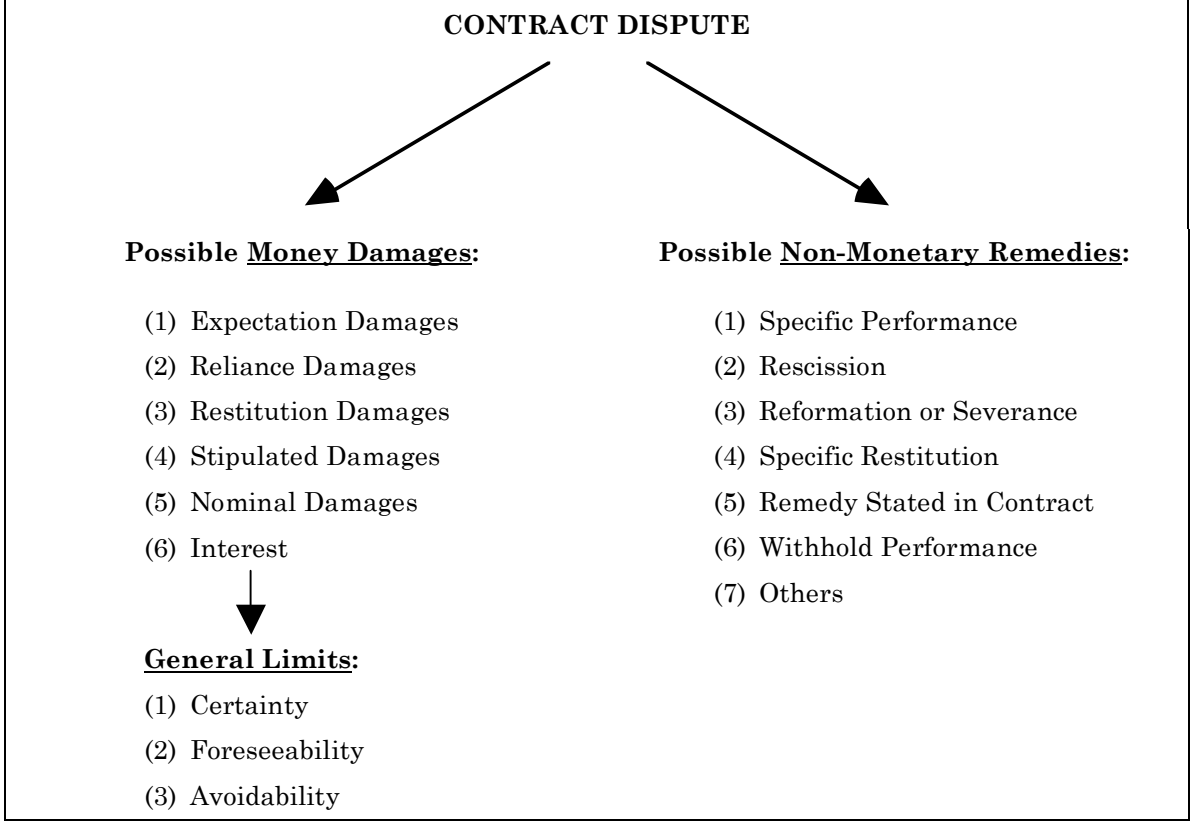
Courts may also order reformation or severance of the contract. That occurs where a court can fairly and effectively change part of an agreement with a formation problem, and then enforce what remains. This remedy seems to be used primarily for formation problems related to mistake or legality, such as for usurious loan agreements.

And courts may order or allow other remedies. These include: specific restitution, which is the return of the actual benefit a party receives, rather than its money value; non-monetary remedies stipulated in the contract, such as the right to the repair or replacement of a product; or the withholding of performance, which would be available if a condition failed.

Remedies may vary to some extent in particular situations. Many jurisdictions have special remedies for sale of goods contracts. Under the Uniform Commercial Code in the United States, sellers and buyers of goods have specific remedies. Under the UCC, when a buyer breaches without finally accepting the goods, and the seller resells the goods in a good faith and reasonable way, the seller can recover the difference between the resale price and the contract price, plus incidental expenses he had in making the resale. If the seller does not resell, he can get the difference between the contract price and the market price at the time and place of tender, plus incidental expenses. When a seller breaches and the buyer does not accept the goods, and the buyer "covers" by finding substitute goods in a good faith and reasonable way, the buyer can recover the difference between the cover price and the contract price, plus incidental and consequential damages.

If the buyer does not cover this way, he can get the difference between the contract price and the market price at the time he learned of the breach, plus incidental and consequential damages. Where courts find a quasi-contract, they generally award restitution, in order to prevent unjust enrichment. And where courts apply promissory estoppel (detrimental reliance), reliance damages appear to be most commonly ordered.

Illustration: Remedies Courts May Order or Allow



*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains a more complete discussion of remedies courts may order or allow.

1.4j Third Parties May Have Contract Rights or Duties in Certain Situations

In some situations, third parties may actually have rights or duties under a contract--even though they are not parties to the contract! In particular, this can occur where a contract party assigns his rights to a third party; a contract party delegates his duties to a third party; or a third party beneficiary gains rights under the contract.

An assignment of rights occurs where a party to a contract transfers his rights under the contract to a third party who is not a party to the original contract. This transfer is not a promise or a contract, but a present-time transfer--like a gift. A valid assignment requires that the assignor of the right communicate his intention to assign the right to the assignee.

Assignments are not subject to the common law requirement of consideration, though assignments without consideration may be terminated in certain cases in common law jurisdictions. Contract rights can generally be assigned. However, many jurisdictions say contract rights cannot be assigned: (1) if the assignment would materially change the duty of the other party to the original contract, materially increase the financial or other risk to that party because of the contract, or substantially reduce the value of the performance that party will receive; (2) if a valid part of the original contract forbids the assignment; or (3) if the assignment violates a statute or public policy. When a party assigns his rights to a third party, the third party gains those rights like the party would gain property. The transferring party no longer has the rights. So the third party basically "stands in the shoes" of the transferring party, holding the same contract rights and subject to the same legal defenses.

******* ***CASE STUDY 22***

FACTS Inserey and Samy make a contract in which Inserey agrees to provide cleaning services to Samy for her book shop at a certain salary. Soon afterwards, Samy tries to assign her right to receive Inserey's services to Bora for his moto repair shop. But Inserey objects, saying that Bora's shop would be far more difficult to clean.

QUESTION OF LAW Can Samy assign her right to receive Inserey's cleaning services to Bora?

DECISION Probably not. Samy probably cannot assign her right to receive Inserey's cleaning services to Bora in this situation, because it would probably cause a material change in Inserey's duties.

Many jurisdictions say that rights cannot be assigned in situations where the assignment would materially change the duties of the other party to the contract. In this case, Samy tried to assign her right to receive Inserey's cleaning services to Bora. But Inserey objected, saying that it would be very different for him to work for Bora, because cleaning Bora's moto repair business would be very different from cleaning Samy's book shop. This assignment would seem to materially change Inserey's duties. So it is probably not valid.

A delegation of duties occurs where a party to a contract transfers his duties under the contract to a third party who is not a party to the original contract. When a party delegates his duties to a third party, the third party may have the option to perform, or he may promise to perform. The third party becomes obligated to perform those duties only if he has promised to perform them. However, unlike in the situation where a party assigns rights, the delegating party remains responsible for the performance of the duties, even after he has delegated them. So if Samy in Case Study 22 delegated her duty to pay Inserey to Jeudy, Samy would remain responsible for the duty,

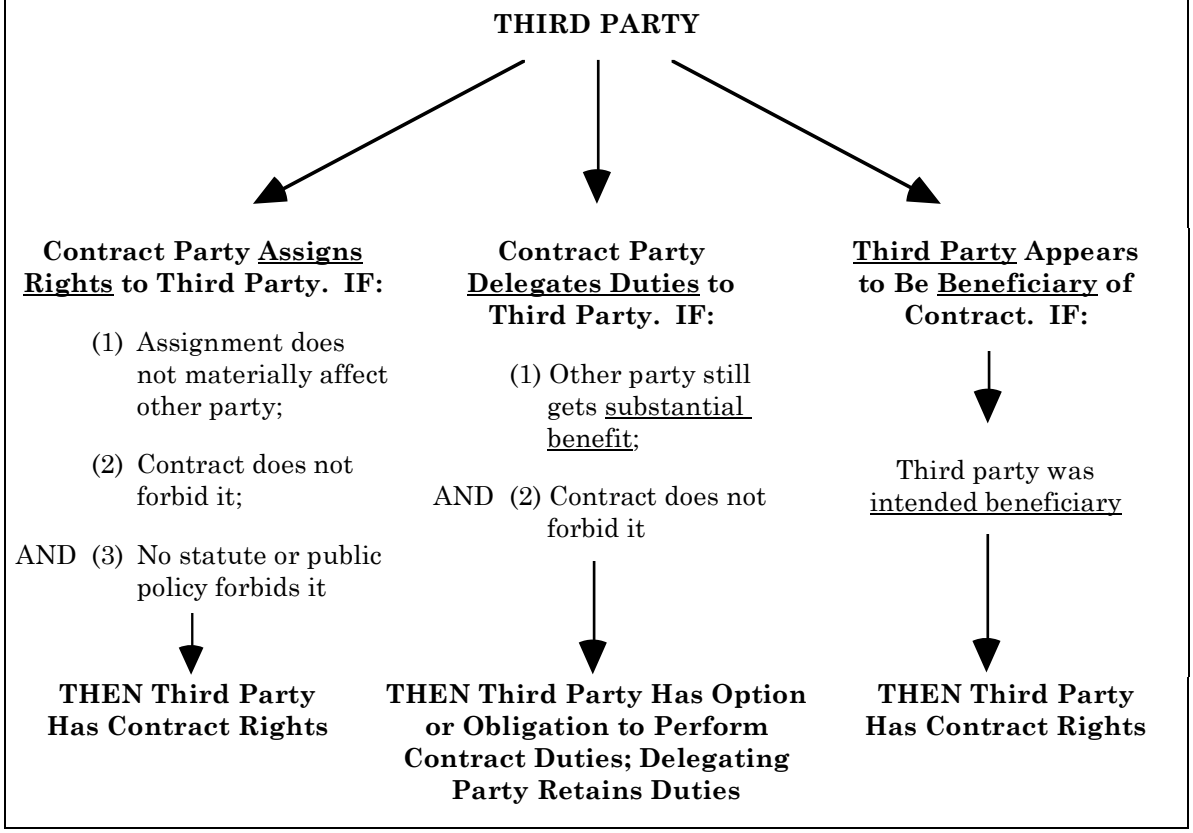
and would have to pay Inserey if Jeudy failed to do so. An effective delegation requires that the delegating party clearly indicate his intent to transfer the contract duty. Contract duties can be delegated as long as the party with the right to receive performance of the duties will still receive the substantial benefit of his original bargain, and no valid part of the original contract forbids the delegation. Types of duties that are likely to be delegable include duties to pay money, or provide commonly available goods or relatively simple services. Duties are less likely to be effectively delegated if they involve personal services or other types of unique skills or abilities, such as the professional services of physicians.

A third party beneficiary can actually gain rights under a contract, even though that third party was not a party to the contract. Many jurisdictions say this occurs only where the third party was an intended beneficiary. That means that the parties to the original contract intended at the time they made their contract that the third party gain the right to enforce it. But if a third party is merely an unintended or "incidental" beneficiary, he cannot enforce the contract. Intended beneficiaries may be donee beneficiaries. They exist where the party receiving the promise that will benefit the third party beneficiary is basically trying to make a gift to the beneficiary. Or they may be creditor beneficiaries. They exist where the party receiving the promise that will benefit the third party beneficiary is trying to fulfill some existing legal duty that he owes or believes he owes to the beneficiary (a duty which remains enforceable). An important reason courts make this donee/creditor distinction is that it may affect when the rights of the beneficiaries "vest." Vesting is basically to become the present property of the holder of the right, so that the right cannot be changed without the holder's consent. Important examples of donee beneficiaries include third party beneficiaries under life insurance policies. Important examples of creditor beneficiaries include loan creditors like banks after a third party assumes a debtor's duty to repay a loan secured by an interest in real property.

For instance, suppose Samy and Bora agree that Bora will buy Samy's shophouse. As part of their contract, Bora assumes Samy's duty to finish repaying a loan which she has with the Big Bank, and which is secured by a mortgage on the shophouse. In that situation, the Bank is a third party beneficiary of the contract between Samy and Bora. That is because the parties clearly intended to benefit the Bank in their contract. So the Bank will actually gain the right to enforce the contract against Bora--and against Samy, in the event that Bora fails to repay the loan according to the loan contract.



Illustration: How Third Parties Can Have Rights or Duties under Contracts



*** ***ADDITIONAL REFERENCE:*** Chapter 11 ("Third Party Rights and Duties") contains a more complete discussion of third party rights and duties.

1.5 The Doctrine of Quasi-Contract Applies Where a Party Seeking Help Cannot Enforce a Contract, but a Court Imposes a Contract Obligation in Order to Avoid Unjust Enrichment

Quasi-contract is a doctrine that courts apply where a party seeking help cannot enforce a contract, but the court imposes contract obligations in order to avoid unjust enrichment. Quasi-contracts are not really contracts. They are usually considered to be one type of restitution. Courts impose quasi-contracts only in certain situations where a party has provided some benefit to another party with a reasonable expectation of compensation. Specifically, many jurisdictions say there are three basic requirements for a quasi-contract to exist: (1) a real case; (2) enrichment of a party; and (3) that the enrichment be unjust. Some of the more important situations where courts may impose quasi-contracts are where the parties do not even have any agreement; an agreement cannot be enforced because of a formation or performance problem; or a breaching party seeks recovery. These ideas will be discussed in more detail below.

1.5a Courts Apply Quasi-Contract in Order to Avoid Unjust Enrichment

As noted above, a quasi-contract is not really a contract, but a legal doctrine that courts apply in order to avoid unjust enrichment.

*** **DEFINITION: Quasi-contract** is a doctrine under which courts impose contract obligations on a party, even though they cannot enforce a contract for the party seeking help, in order to avoid unjust enrichment.

Quasi-contract is often referred to as "restitution," or a type of restitution. It appears that authorities generally consider quasi-contract to be one part of the larger legal area of restitution, which has the goal of avoiding unjust enrichment in a variety of areas, including contract law. In any case, this text will often use the two terms to refer to situations where courts act to avoid unjust enrichment.

The term "quasi-contract" is based on the word "quasi," which can mean seemingly, somewhat or not really. This shows that a quasi-contract is seemingly or in some ways like a contract, but is not really a contract. It is a doctrine under which a court imposes contract obligations, but those obligations are not really based on an enforceable contract. They are based on a court's actions to achieve the important legal goal of avoiding unjust enrichment. In fact, some authorities refer to quasi-contracts as "constructive contracts," since the court actually "builds" the contract obligation itself.

One of the most common examples of a situation where a court might apply quasi-contract is where a health care worker provides emergency care to an unconscious car accident victim. Suppose a doctor named Sokna found Vichda unconscious and seriously injured by the side of the road following a bad moto accident. If Sokna provided needed health care to Vichda, Sokna would probably be able to recover the reasonable value of the services she provided under the doctrine of quasi-contract--even though she could not possibly have made an enforceable contract with the unconscious Vichda! The reason quasi-contract might be available is that otherwise there would probably be unjust enrichment of Vichda.

Where courts do impose a quasi-contract, it appears that the remedy they most often award is restitution damages. This was briefly noted in Section 1.4i above, and will be discussed in more detail in Chapter 10 ("Remedies"), Section 10.8b. Restitution generally involves the court ordering one party to give another party the reasonable value of the benefit that first party received from the other party.

Although restitution appears to be the remedy most commonly awarded where a court imposes a quasi-contract, reliance damages may also be awarded in certain cases. Such cases include where the amount of enrichment is difficult to measure, or where restitution alone will not achieve justice.

For instance, in the health care example above, suppose that Sokna had to buy some special tools in order to treat Vichda, but that those tools were not really useful in Sokna's usual medical practice. This might occur if Vichda was trapped in a crashed car, and Sokna had to buy a hacksaw and a crowbar to get him out of the car and treat him. The costs of those tools would probably be considered a reliance expense, and a court might award Sokna those damages if it felt that was necessary to avoid injustice.

*** ***WHY IS THIS IMPORTANT?*** Why do courts impose contract obligations under the doctrine of quasi-contract, even though they cannot actually enforce a contract for the party seeking help?

Courts apply quasi-contract, a form of restitution, in order to achieve justice in situations where the other contract law rules may not be able to do so. In this way, quasi-contract is a kind of "gap-filler." Sometimes one party provides a benefit to another party with some reasonable expectation of compensation, but the party providing the benefit cannot enforce any contract. This could occur because the parties have no agreement, or because there is some problem with the formation or performance of the agreement. In cases like this, there might be unjust enrichment if the party who received the benefit was not required to compensate the party who provided the benefit. So courts will impose contract obligations, even though they cannot enforce any agreement for the party seeking help, in order to achieve justice. This legal goal of avoiding unjust enrichment is present in a number of legal areas besides contract law where restitution may apply.

Of course, the power to impose contract obligations even though no agreement can be enforced for the party seeking help is a great power. So courts are very careful to apply it only in those cases where unjust enrichment really exists.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies"), Sections 10.4a and 10.8b contain a more complete discussion of remedies where courts impose a quasi-contract, particularly restitution damages.

1.5b The Basic Elements of Quasi-Contract

The doctrine of quasi-contract is used only in certain situations. Courts will not use it in every case where one party receives something from another party. In fact, as noted above, many jurisdictions say there are three basic requirements in order for a court to impose a quasi-contract:

(1) there must be a real case between parties with legal interests in the matter;

(2) there must be enrichment of one of the parties;

AND (3) the enrichment must be unjust.

These three requirements are explained in more detail below.

(1) A Real Case -- The first basic requirement for a court to find a quasi-contract to exist is a real case. This means that one party (the plaintiff) with a real legal interest in the matter must formally ask a court to decide a legal dispute he has with another party (the defendant). A court has no power to act in such a situation unless a proper party actually asks it to act. In fact, it is a fundamental legal rule in free market jurisdictions that courts have no power to act unless there is a genuine dispute between parties, and at least one of the parties asks the court to intervene.

This basic rule applies to contract and quasi-contract disputes in the same way as it does to other legal disputes. It does not matter if the court, or some other party not involved in the situation, thinks there may be unjust enrichment. Those parties do not have the power to create a real case about the situation.

For instance, in the accident victim example above, this rule would basically mean that Sokna would have to ask a court to resolve her dispute with Vichda. A court could not act in the dispute unless Sokna did that. In addition, it is unlikely that anyone else would be able to persuade a court to act for Sokna. So even if Sokna's sister Sereypheap was very angry because Vichda would not pay Sokna for her services, Sereypheap could not generally persuade a court to act in the dispute.

(2) Enrichment of a Party -- The second requirement for a court to impose a quasi-contract is enrichment of a party. This will typically be enrichment of the defendant in the court case by the plaintiff.

Enrichment simply means that the defendant must have benefited in some way. Often this is easy to see. For instance, in the accident victim example above, if Sokna provides medical care and Vichda's condition improves, it is easy to see that Vichda has received a benefit. Or if a worker repairs the leaky roof of someone's house so that it does not leak, it is obvious that the house owner has benefited.

However, sometimes enrichment is not so easy to see. Suppose Sokna provided competent and valuable medical care to Vichda at the side of the road, but Vichda was so badly injured that he died despite Sokna's efforts. In that situation, it appears that many jurisdictions would still say that Vichda's estate could be liable under quasi-contract for the reasonable value of Sokna's services! The reason seems to be that Sokna has still provided something of value to Vichda--even though Vichda was unable to use the services much because his condition was so poor. In addition, if Sokna was not compensated, she would probably have an unjust loss.

(3) The Enrichment Must Be Unjust -- The final element needed for a quasi-contract to exist is that the enrichment must be unjust. This basically

means that a court must feel that it would truly be unfair if one party was not ordered to re-pay another party for something that party provided to the first party. In other words, a court must believe that there will be unjust enrichment of one party (the defendant) and an unjust loss for the other (the plaintiff).

Not all enrichment is unjust. Sometimes there is enrichment, but none or only some of it is considered to be "unjust." In order to determine whether enrichment is unjust, a court must consider all the circumstances of each case. One important element many courts appear to require in order to find unjust enrichment is that the party who provided the benefit to another actually expected compensation at the time he provided it, and that that expectation was reasonable. For instance, if an aid organization helps a poor person with the understanding that the help is free, the aid group cannot later ask the aid recipient to compensate it--even if that poor person has become rich! This is because the group never actually expected to be paid. Consider also the following Case Study.

*** ***CASE STUDY 23***

FACTS Chito is riding his moto one day when he notices that Lam's house is not as well protected from potential flooding as it could be, since flooding occurs every year in the area around Lam's house. The next day, after Lam has gone to work, Chito comes to Lam's house and makes improvements that will protect the house better from flooding. But Chito never says anything to Lam about what he is doing. When Lam gets back from work, he is shocked.

The next day, Chito comes and asks Lam to pay him for his work. Lam refuses. Lam admits that his house has been improved. But Lam says that he never asked Chito to do the work, and that he cannot afford to pay for it anyway. Chito asks the court for help.

QUESTION OF LAW Can Chito recover anything for the benefit he has provided to Lam, under the doctrine of quasi-contract?

DECISION Probably not. Chito probably cannot recover anything from Lam here because, although Chito did provide enrichment to Lam, it was probably not unjust enrichment.

Many jurisdictions say that courts can impose contract obligations under the doctrine of quasi-contract in real cases in order to avoid unjust enrichment, even though the court cannot enforce any contract for the party seeking help.

In this case, Chito asked the court for help with regard to the work he did on Lam's house, so there is a real case. And Chito clearly provided some benefit to Lam by improving his house, so there is enrichment.

However, the enrichment is probably not unjust. This is because, although Chito may have actually expected Lam to pay him for his work, Chito really had no good reason to expect that Lam would do so, and it would probably be unjust to ask Lam to do so. Chito never asked Lam whether he wanted the work done. Nothing prevented Chito from asking Lam this. In addition, Lam did not want the work done, and he cannot afford to pay for it. In this situation, the enrichment to Lam is not unjust. And Chito's loss is not unjust either. So a court would be very unlikely to order Lam to pay anything to Chito under the doctrine of quasi-contract.

Some jurisdictions call parties like Chito in Case Study 23 "officious intermeddlers." This basically means that such persons unjustifiably meddle in the affairs of others.

However, one situation where unjust enrichment might occur in this kind of case would be if the work was done in an emergency. For example, in Case Study 23, suppose that when Chito saw Lam's house, flood waters were very high around the house. Flooding might have severely damaged the house at any time. Suppose Chito tried to find Lam to tell him about the problem, but no one was home. So Chito quickly did some work to keep the flooding out. In that situation, the enrichment of Lam would likely be unjust. This is because Chito was not a "meddler," but someone who was trying to save Lam's house in an emergency, and who tried his best to contact Lam about the problem. Here, it would be reasonable for Chito to expect compensation for his work, and a court would likely order Lam to pay Chito its reasonable value. This example is similar to the unconscious accident victim example above.

Another situation where unjust enrichment might exist in this type of case would be where there was a mistake. Suppose Chito in Case Study 23 made a contract to strengthen the house of Lam's neighbor to protect it from flooding, but Chito got confused and did the work on Lam's house by mistake. In that case, it might still be unreasonable to expect Lam to pay. But suppose Lam was actually trying to sell his house at the time, and that the improvements Chito provided allowed Lam to get more money for the house. It might be unjust to allow Lam to be enriched in that way without compensating Chito. If a court did decide that there was unjust enrichment, it would probably order Lam to pay Chito the reasonable value of his services, not the actual increase in the sale price of the house, which would likely be more than the reasonable value of the services. This is because the reasonable value of the services would probably be a better measure of how much Lam had been unjustly enriched--the amount Lam would have normally had to pay someone like Chito to do the work if Lam had actually requested it. The rest of the money would be enrichment to Lam, but probably not unjust enrichment.

Obviously, it can be difficult for a court to decide whether enrichment is really unjust, and how much unjust enrichment exists. So it is important for

the court to consider very carefully the factors discussed above and all the circumstances of each case, and to act only where enrichment really is unjust.

Sometimes it can be easy to confuse quasi-contract with implied contracts, which were discussed in Section 1.3d above. In both situations, the parties may not use words to express an agreement, but a court may enforce contract obligations anyway. However, the nature and requirements of quasi-contracts and implied contracts are actually very different. The following chart tries to illustrate this.

Illustration: Comparison of Implied Contracts and Quasi-Contracts

	IMPLIED CONTRACT	QUASI-CONTRACT
1. What is it?	Enforceable contract based on the conduct (not words) of the parties.	Not a contract, but contract obligations court imposes to avoid unjust enrichment.
2. How is it created?	By the parties, who make a contract with their actions.	By the court, which imposes contract obligations whether parties have an agreement or not.
3. Why does the court act?	To enforce the agreement of the parties.	To avoid unjust enrichment of a party.
4. What remedy will court order?	Full range of contract remedies might be available.	Court likely to order restitution (reasonable value of benefit given) or perhaps reliance.
5. What are some key differences?	Enforcement of a valid contract.	Not enforcement of a valid contract.
	Purpose is to enforce agreement of the parties.	Purpose is to avoid unjust enrichment.

1.5c Important Situations Where Courts May Use Quasi-Contract

As noted above, courts are very careful to use the doctrine of quasi-contract only in situations where there really is unjust enrichment. However, there are a number of different types of situations where the doctrine may be used. As noted in Section 1.5, some of the more important situations where courts may impose quasi-contract obligations are where:

(1) parties do not even have any agreement;

(2) an agreement cannot be enforced because of a formation or performance problem; or

(3) a breaching party seeks recovery.

Each of these situations will be discussed in more detail below. They are also discussed in some detail in Chapter 10 ("Remedies"), Section 10.4a, regarding restitution damages.

(1) Parties Do Not Even Have an Agreement -- Sometimes courts will decide to impose quasi-contracts even though parties do not even have any agreement at all together--including in situations where they have not even discussed one! Of course, this has been the case with a number of the examples discussed above. This Section will briefly discuss some of the important situations where this might occur.

One situation where a court may impose a quasi-contract even though there is no agreement is where one party provides some benefit to another in an emergency. Of course, this was the situation in the example above involving the unconscious accident victim. It was also the situation in the example related to Case Study 23 in which Chito did work on Lam's house to save it from flooding which had placed it in danger. Important factors here include whether the situation was really an emergency, and whether the person providing the benefit tried reasonably but failed to contact the other party to ask if that party wanted the work done. If both of those factors are present, it appears more likely that a court will find some amount of unjust enrichment.

Another situation where a quasi-contract may occur despite the lack of any agreement is where a party provides benefits by mistake. This was the case in the example related to Case Study 23 where Chito did work on Lam's house by mistake, when he should have done the work for Lam's neighbor. In that kind of situation, important factors seem to be how much the party receiving the benefit has really benefited, and whether it seems fair to make that party pay for a benefit for which he never asked. For instance, if Lam was selling his house and he got more money because of the flooding repair work, it seems clear that he benefited, and it seems fair that he should compensate Chito. But if Lam was not selling his house, and especially if he could not really afford the work, then it seems much less likely that a court would find unjust enrichment and impose a quasi-contract.

Another situation where a court might impose a quasi-contract is where a party supplies something another party needs to live--even where there is actually a refusal to agree to accept the benefit! Suppose a nurse sees a child who is clearly very sick with a life-threatening illness. In many jurisdictions, the nurse would normally require the permission of the child's parent or guardian to treat the child. Suppose the nurse finds the parents and asks, but they refuse permission for him to treat the child. The nurse treats the child despite the parents' refusal. In some jurisdictions, the nurse might be able to recover for the reasonable value of his services from the parents under quasi-contract. This is because parents generally have a legal duty to care for their children, because the nurse appeared to provide a benefit to the child (and therefore to the parents), and because it might be unjust not to compensate

the nurse--even though the parents actually refused to allow him to treat the child! Of course, this kind of case would not be easy to decide. It could involve difficult issues about the different interests of children, parents, and society, and competing views about health and well-being.

(2) Agreement Cannot Be Enforced Because of Formation or Performance Problem -- A very important situation where a court may use quasi-contract is where the parties actually have some agreement, but it cannot be enforced because of one of a wide variety of the formation or performance problems discussed earlier in this Chapter. This could occur where an agreement cannot be enforced because of formation problems such as a failure to meet a writing requirement, a lack of capacity, or mistake, or because of performance problems such as rescission or impracticability. In these cases, even though a party cannot enforce the agreement, courts may order another party to pay him a certain amount in order to avoid unjust enrichment.

***** ***CASE STUDY 24***

FACTS Piseth and Huot agree that Piseth will buy Huot's bicycle for $50. Their agreement is that Piseth will pay Huot on the day of the agreement, and get the bicycle from Huot the next day, after Huot has made certain repairs. However, the parties soon learn that, at the time they made their agreement, the bicycle had already been destroyed by a grenade explosion at the casino next to Huot's house! Neither party knew that at the time of the agreement.

The parties agree that their prior agreement was void because of this mutual mistake. But Huot refuses to return the $50 Piseth paid him, claiming that this is not possible with void agreements. Piseth asks the court for help.

QUESTION OF LAW Can Piseth get restitution of his money in this case?

DECISION Yes. Piseth can get restitution of his $50 under the doctrine of quasi-contract because otherwise, Huot would be unjustly enriched.

Many jurisdictions say that courts can impose contract obligations under the doctrine of quasi-contract in real cases in order to avoid unjust enrichment, even though the court cannot enforce any contract for the party seeking help. In this case, Piseth and Huot agreed that Piseth would buy Huot's bicycle for $50. But they later learned that the bicycle had been destroyed before the agreement was made. The agreement was void because of this mutual mistake. In this situation, there is a real case, because Piseth has asked the court for help. There has been enrichment of Huot, since he has received $50 from Piseth. And it would unjust if Huot were allowed to keep this money, since he has done nothing to earn it, and Piseth has received nothing in return. So a court would order Huot to return the $50 to Piseth under the doctrine of quasi-contract.

(3) Breaching Party Seeks Recovery -- Another important situation where courts in many jurisdictions may impose a quasi-contract is where a party who has breached a contract seeks restitution of benefits he has provided to the other party. It seems that in the past many courts would not allowing a breaching party to recover for such benefits. However, it now appears that many jurisdictions will allow such parties to recover for the benefits they have given under the contract.

There are some limits on the ability of breaching parties to get restitution under quasi-contract. Obviously, the amount of such restitution will be reduced by the amount of any damage the breaching party has caused to the other party. Also, many courts limit the amount of restitution for a breaching party to the portion of the contract price that the breaching party would have received for the benefit he provided. And many courts appear to say that a breaching party cannot get such restitution where the breach was intentional, rather than merely negligent or accidental. This is further discussed in Chapter 10 ("Remedies"), Section 10.4a.

For example, in the Case Study 24 situation, suppose the bicycle was not destroyed, but that Piseth paid only $10 of the money the contract required, thus materially breaching the contract. Huot refused to deliver the bicycle, correctly saying his duty to do so had not become due. Piseth asked for his $10 back, but Huot refused. In this situation, Piseth could probably get restitution of his $10 under the doctrine of quasi-contract. Of course, this restitution would be reduced by any damage Huot could prove he suffered because of Piseth's breach.

*** ***ADDITIONAL REFERENCE:*** Chapters 2-7 discuss formation problems which may result in a court imposing a quasi-contract; Chapter 9 ("Performance and Discharge of Duties") discusses performance problems that may result in a court imposing a quasi-contract; and Chapter 10 ("Remedies"), Sections 10.4a and 10.8b discuss remedies where courts impose a quasi-contract, particularly restitution damages.

1.6 Basic Aspects of Contract Law in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the Cambodian legal tradition and the civil law tradition to the basic principles discussed above seem generally compatible with the approach discussed in this Chapter. Of course, a number of the elements and ideas discussed in this Chapter and the rest of this book do not appear in the Cambodian law or civil law traditions. And a number of elements from those traditions do not appear in this book. But the focus of this text is on general compatibility, and any truly important differences. Some of the significant differences among the traditions will be discussed briefly below, and discussed in more detail in the rest of the book.

In general, it is crucial to understand that legal traditions and rules vary from one jurisdiction to the next. Therefore, it is very important to check the local law that applies to any particular contract or transaction.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) and other Cambodian laws contain many provisions relevant to the basic aspects of contract law discussed above. Most of these provisions seem generally compatible with the ideas discussed in this text. Of course there are differences, and certain ideas and elements in each tradition do not appear in the other tradition. Perhaps some of the more significant differences are that Cambodian law does not require consideration for a contract to be valid, and that it does not appear to contain ideas directly comparable to quasi-contract, promissory estoppel, the parol evidence rule, or conditions. This text will now briefly compare the approaches of the two traditions to the material discussed in each Chapter of this book.

With regard to the introductory material presented earlier in Chapter 1, the approach of Cambodian law appears to be generally compatible with the approach explained in that material. With respect to basic ways to classify contracts, Decree #38D describes which agreements are valid, voidable, and void. Article 3 provides that contracts are valid provided that they "arise out of a real and free agreement," are made by parties with capacity, and have a subject matter that is certain, lawful, possible to perform, and "consistent with public order and good custom." Article 5 provides that agreements are void if they are illegal, "not consistent with public order or good custom," "not consistent with social interests or principles of social ethics," or have a subject matter that is impossible to perform. Article 6 provides that contracts are voidable where they do not result from a "real or free agreement," or are made by a party who lacks capacity. Article 4 of Decree #38D provides that contracts may generally be made orally or in writing, though certain provisions of the law state that certain types of contracts must be written to be enforceable.

With regard to the doctrine of quasi-contract explained earlier in Chapter 1, Decree #38D does not appear to contain anything directly comparable to that doctrine. However, certain provisions in Decree #38D would appear to accomplish similar results. For example, Article 21 provides that following the avoidance of a contract, the "situation prior to entering into the contract shall be restored." This would seem to be a reliance remedy, which would include restitution, thus preventing unjust enrichment even where a contract was voidable.

With regard to real agreement (offer and acceptance), the approach of Cambodian law also appears generally compatible with that discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"). Articles 1 and 3 of Decree #38D show that the Decree requires contracts to be the result of a "real and free agreement." The Decree does not appear to discuss "offer" and "acceptance" specifically.

Decree #38D does not require consideration in order for contracts to be valid, unlike common law jurisdictions, as noted in Chapter 3 ("Consideration"). However, Article 12 does appear to suggest that if the value of what each party gives in a contract is not equal, then the aggrieved party can sue to rescind the contract.

With regard to capacity, the approach of Cambodian law seems generally consistent with that discussed in Chapter 4 ("Capacity"). Articles 3 and 6 of Decree #38D show that a contract is voidable if a party to the contract lacks capacity. Under Article 14, minors under 18 years of age and "interdicted persons" lack capacity.

With regard to legality, the approach of Cambodian law seems generally consistent with that discussed in Chapter 5 ("Legality"). Articles 3 and 5 of Decree #38D show that agreements are void if they are illegal, "not consistent with public order or good custom," or "not consistent with social interests or principles of social ethics," or have a subject matter which is impossible to perform. Other provisions in Decree #38D and many other laws specify some of the categories of agreements that are illegal.

With regard to formality, the approach of Cambodian law seems generally compatible with that discussed in Chapter 6 ("Formality"). Article 4 of Decree #38D provides that contracts may generally be oral or written, but that certain contracts may be subject to certain "formalities." Decree #38D and other Cambodian laws contain a number of writing requirements.

With regard to the other formation problems discussed in Chapter 7 ("Other Contract Formation Problems"), the approach of Cambodian law seems generally consistent with that discussed in this text. Perhaps the most important difference is that Decree #38D does not appear to contain any provisions that correspond to the doctrine of promissory estoppel.

With regard to contract interpretation problems, the approach of Cambodian law seems basically consistent with that discussed in Chapter 8 ("Interpretation of Contracts"). Perhaps the most important difference is that Decree #38D does not appear to contain any rule comparable to the parol evidence rule.

With respect to performance and discharge of duties, Cambodian law addresses many of the same issues as the approach discussed in Chapter 9 ("Performance and Discharge of Duties"), and some elements of Cambodian law are comparable to those discussed in that Chapter. Decree #38D regulates contract performance, particularly in Articles 29-33, which contain general provisions about performance, and in Chapter 2, which governs the performance of particular types of contracts. One important difference is that Decree #38D does not contain the specific idea of conditions, though there are provisions about specific types of contracts that seem to accomplish similar goals.

With regard to remedies, the approach of Cambodian law appears to be generally compatible with the one discussed in Chapter 10 ("Remedies"), though in many cases the approaches do not use the same terminology. Decree #38D describes remedies available where there is a formation problem (Articles 18-21), where there is a failure to perform properly (Article 31), and in certain particular situations (Chapter 2).

Finally, with respect to third party rights and duties, the approach of Cambodian law seems generally compatible with the one discussed in Chapter 11 ("Third Party Rights and Duties"). For example, Decree #38D contains provisions dealing with third party rights and duties with regard to sales contracts (Chapter 2, Section 1), leases (Article 103), and suretyship contracts (Article 112).

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to the basic aspects of contract law discussed above appears to be generally compatible with the one discussed in this Chapter. Of course, a number of ideas and elements do not appear in both traditions, and there are some differences. Some of these are discussed briefly below and in the rest of this text. The exact rules about these basic aspects vary to some extent in all jurisdictions.

In general, it appears that there are few truly significant substantive differences between the common law and civil law traditions with regard to contract law. Some of the more significant differences are that common law jurisdictions generally require consideration in order for a contract to be valid, but civil law jurisdictions do not; that the specific doctrine of promissory estoppel does not appear to exist in civil law jurisdictions; that many civil law jurisdictions do not seem to apply any rule directly comparable to the parol evidence rule; and that civil law courts are more likely to order specific performance, even where the subject matter of a contract is not unique. This text will now briefly compare the approaches of the two traditions to the material in each Chapter in this text.

With regard to the introductory material presented earlier in Chapter 1, the approach of the civil law tradition appears to be generally compatible with the approach discussed in that material. With respect to basic ways to classify contracts, it appears that civil law jurisdictions may classify agreements in categories roughly comparable to the valid, voidable and void categories described in this Chapter. One difference is that many civil law and common law jurisdictions seem to define the terms "bilateral contract" and "unilateral contract" in different ways. In common law jurisdictions, a bilateral contract is basically an exchange of a promise for a promise, while a unilateral contract is basically an exchange of a promise for an act. However, in civil law jurisdictions like France, it appears that a bilateral contract is one with obligations on both sides, whereas a unilateral contract is one with obligations on only one side, as in the case of an agreement to give a gift. That kind of unilateral agreement might not be enforceable at all in common law jurisdictions, because of a lack of consideration.

The doctrine of quasi-contract, which was discussed earlier in Chapter 1, appears to exist in at least some civil law jurisdictions in a form which is very roughly comparable to that explained here. For example, this seems to be the case in France.

With regard to real agreement (offer and acceptance), the approach of the civil law tradition also appears generally compatible with that discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"). There are a few significant differences. First, as noted above, civil law jurisdictions like France appear to define bilateral and unilateral contracts differently, which would affect to some extent the principles explained in Chapter 2 with regard to how those kinds of contracts are formed. Second, many civil law jurisdictions appear to say that an offeror cannot revoke an offer for a reasonable time, as long as no expiration time is specified in the offer itself. Third, some civil law jurisdictions appear to say that acceptances are generally effective on receipt.

Civil law jurisdictions do not require consideration in order for contracts to be valid, unlike common law jurisdictions, as noted in Chapter 3 ("Consideration"). This may be the most important single difference between the traditions.

With regard to capacity, the approach of the civil law tradition seems generally consistent with that discussed in Chapter 4 ("Capacity"). For example, French law appears to provide that contracts made by minors and "protected adults" are generally voidable.

With regard to legality, the approach of the civil law tradition seems generally consistent with that discussed in Chapter 5 ("Legality"). Jurisdictions such as France will not enforce agreements contrary to "public order," which is roughly comparable to "public policy."

With regard to formality, the approach of the civil law tradition seems generally consistent with that discussed in Chapter 6 ("Formality"). The specific types of contracts that must be written to be enforceable are generally comparable to those discussed in this text.

With regard to the other formation problems discussed in Chapter 7 ("Other Contract Formation Problems"), the approach of the civil law tradition seems generally consistent with that discussed in this text. Perhaps the most significant difference is that there does not appear to be any civil law equivalent to the doctrine of promissory estoppel, though civil law jurisdictions may need it less with their different rules about real agreement and consideration. In addition, though many civil law jurisdictions do not apply the specific doctrines of undue influence or unconscionability, they do appear to use comparable doctrines to deal with such formation problems.

With regard to contract interpretation problems, the approach of the civil law tradition seems broadly consistent with that discussed in Chapter 8 ("Interpretation of Contracts"). Perhaps the most significant difference is that many civil law jurisdictions do not seem to apply any rule directly comparable to the parol evidence rule.

With respect to performance and discharge of duties, the approach of the civil law tradition seems generally comparable to that discussed in Chapter 9 ("Performance and Discharge of Duties"). Civil law jurisdictions may not use all of the same terminology that common law jurisdictions do. In addition, some civil law jurisdictions may limit the use of the doctrine of impossibility to situations where performance really is impossible, rather than merely impracticable.

With regard to remedies, the approach of the civil law tradition appears to be generally compatible with the one discussed in Chapter 10 ("Remedies"). Perhaps the most important difference in this area is that civil law courts seem more likely to order specific performance than common law courts are, and that specific performance might be available even for contracts involving commonly available goods in civil law jurisdictions. Another difference is that civil law jurisdictions may be somewhat more willing to order contract remedies that may be viewed as punitive than common law jurisdictions are.

Finally, with respect to third party rights and duties, the approach of the civil law tradition seems generally compatible with the one discussed in Chapter 11 ("Third Party Rights and Duties"). It appears that civil law jurisdictions like France apply doctrines that are comparable to the concepts of assignment of rights, delegation of duties, and third party beneficiaries.

*** ***ADDITIONAL REFERENCE:*** Chapters 2-11 discuss the approaches of the Cambodian and civil law traditions to contract law in more detail.

1.7 Questions for Review

CHAPTER 1 -- QUESTIONS FOR REVIEW

1. What is a contract?

2. Why is contract law important?

3. What is the general goal of law?

4. Explain the basic natures of the civil law tradition and the common law tradition.

5. Explain the differences between valid, voidable and void agreements.

6. Explain the differences between bilateral and unilateral contracts.

7. Explain the difference between executed and executory contracts.

8. Explain the difference between express and implied contracts.

9. Explain the difference between oral and written contracts.

10. Which contracts should parties put in writing? Why?

11. Explain the differences between formal and simple contracts.

12. What are the six basic elements many jurisdictions require in order for a contract to be valid?

13. What is required for a valid offer to exist?

14. What is required for a proper acceptance?

15. What is consideration, and under what circumstances is it required?

16. What is capacity, and who may lack capacity to some extent?

17. In what situations may an agreement lack legality?

18. Name some important types of agreements that may need to be written to be enforceable.

19. Explain some other formation problems that may affect the enforceability of an agreement.

20. Describe some methods courts use to help them interpret contracts.

21. What is the parol evidence rule?

22. What are the differences between promises and conditions?

23. How may conditions be fulfilled or excused?

24. How may contract duties be discharged?

25. What remedies may courts order or allow where there is a contract dispute?

26. In what situations may third parties have contract rights or duties?

27. What are the basic elements of a quasi-contract?

28. In what situations might courts impose quasi-contracts?

29. Is the Cambodian law approach to basic aspects of contract law generally compatible with the approach discussed in this Chapter? What are some important differences?

30. Is the civil law approach to basic aspects of contract law generally compatible with the approach discussed in this Chapter? What are some important differences?

CHAPTER TWO

REAL AGREEMENT (OFFER AND ACCEPTANCE)

2.1 Introduction

Perhaps the most basic formation requirement for an enforceable contract to exist is real agreement. Real agreement means that the parties to a contract actually agree to make a legally binding agreement together. This may sound simple, but it can be fairly complex. So there are many rules that govern whether real agreement exists. This Chapter explains many of the more important of these rules. The rules were already discussed much more briefly in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4a.

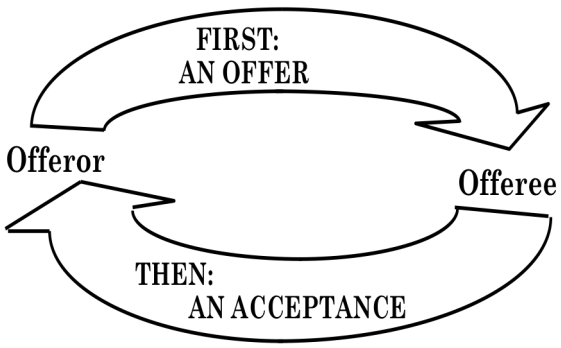
In many free market jurisdictions, real agreement requires a valid offer and a proper acceptance. So in these jurisdictions, in order to meet the important requirement of real agreement, there must be:

(1) a valid offer to make a contract by one party, and

(2) a proper acceptance of that offer by another party.

The party who makes the offer is called the offeror. The party to whom the offer is made, and who can make a proper acceptance, is called the offeree. The following chart shows in a very basic way how offer and acceptance can create real agreement.

Illustration: How Offer and Acceptance Create Real Agreement



Of course, in order for a contract to exist, the agreement of the parties must also meet the other formation requirements explained in this book. These are requirements as to consideration (in common law jurisdictions), capacity, legality, formality, and other formation problems. These important requirements are explained in more detail in Chapters 3-7.

Offers and acceptances may take many different forms. As explained in Chapter 1, parties may make their contracts in a variety of ways, such as expressly or impliedly, orally or in writing. Valid offers and proper acceptances can also be made in all these different ways, and in combinations of these different ways. So when there is any dispute about whether real agreement exists, courts are careful to look at all the circumstances surrounding the dispute to see if there is a valid offer and proper acceptance, in some form.

It is also important to realize that it is not always possible to identify a distinct "offer" and "acceptance." This is especially true when the parties make an implied contract. It can be also be the case where the parties make an express contract through a long exchange of communications back and forth. In these kinds of cases, it may be difficult or impossible to say: "this was the offer, and that was the acceptance." That is because the various elements of offer and acceptance might be found in several different expressions of the parties, such as in a number of different documents. But what matters is that, whatever the form of the agreements, a court can find all the elements needed for a valid offer and proper acceptance to exist.

This Chapter explains how many jurisdictions analyze whether real agreement exists. As noted above, this requires a valid offer. First, Section 2.2 explains that an offer is a proposal to make a contract. Then, the Chapter explains that a valid offer must be: (1) seriously intended; (2) definite and reasonably clear; and (3) communicated to the offeree. However, preliminary negotiations and invitations to negotiate are generally not valid offers. Valid offers are discussed in Section 2.3. Offers terminate--and are no longer valid--in several ways. First, as Section 2.4 explains, the offeror may end the offer by revoking it, although that may not be possible in situations involving option contracts, irrevocable or firm offers for the sale of goods, part performance of certain unilateral contract offers, or promissory estoppel. Second, as Section 2.5 explains, the offeree may end the offer by rejecting it or making a counter-offer. Third, as Section 2.6 explains, other specific events or circumstances may end the offer. These other events include lapse; the occurrence of a condition specified in the offer; the death or adjudicated incompetence of a party or person essential to the proposed contract; the destruction of the specific subject matter of the contract; and a change in the law making the offer illegal.

Real agreement also requires a proper acceptance. As Section 2.7 explains, an acceptance is an offeree's indication of agreement with an offer. In general, only the intended offeree can make a proper acceptance,

as discussed in Section 2.8. How offerees can properly accept an offer depends on whether the offer is for a unilateral or bilateral contract. In common law jurisdictions, offerees can properly accept unilateral contract offers by fully performing the act requested in the offer. Section 2.9 explains this. Offerees can properly accept bilateral contract offers by communicating in a proper manner the promise requested. This important rule, as discussed in Section 2.10, generally requires that the acceptance: be communicated to the offeror; be unequivocal and unconditional; be identical to the terms of the offer (a "mirror image"); and occur in a proper manner, including meeting any special requirements of the offeror. Acceptances may be effective either on dispatch or on receipt by the offeror, depending on the situation. If it is not clear whether an offer is one for a unilateral or bilateral contract--whether it is requesting an act or a return promise--most jurisdictions appear to say that the offeree can accept either by performing the act or making the return promise. This is explained in Section 2.11.

Finally, Section 2.12 discusses the approaches of the Cambodian legal tradition and the civil law tradition to real agreement. Section 2.13 contains Questions for Review.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4a contains a more concise discussion of real agreement (offer and acceptance).

2.2 An Offer Is a Proposal to Make a Contract

As noted in Section 2.1 above, the first element required for real agreement to exist is a valid offer.

*** **DEFINITION:** An **offer** is a proposal to make a contract.

As also noted above, the party who makes the offer is called the offeror, and the party to whom the offer is made is called the offeree.

*** **DEFINITION:** An **offeror** is a party who makes an offer.

*** **DEFINITION:** An **offeree** is a party to whom an offer is made.

A valid offer creates the potential for a contract. It is an invitation from the offeror to the offeree to create a contract according to the terms of the offer. The offeror is basically saying to the offeree: "Here is a proposal for a contract between you and me. If you agree to this proposal, then we will have a contract as stated in this proposal."

For example, suppose Rith says to Mony: "I will sell you this mango for 2,000 riels." Rith has made an offer to Mony. Rith is the offeror, and Mony is the offeree.

Offers may take many different forms. Some of the situations in which offers can occur are:

(1) in face-to-face negotiations between the parties;

(2) in a document such as a letter or note;

(3) in a phone call;

(4) through special forms prepared for particular transactions; and

(5) through non-verbal conduct of one of the parties.

******* ***CASE STUDY 25***

FACTS One day at the market, Chinda sees his old friend Bunny. Chinda says to Bunny: "I will give you this watch if you pay me $25."

QUESTION OF LAW Has Chinda made an offer to Bunny?

DECISION Yes. Chinda has made an offer to Bunny.

Offers exist where one party makes a proposal to make a contract with another party. In this case, Chinda promised to give Bunny a watch if Bunny paid $25 for it. This is an offer to make a contract on those terms. Chinda is the offeror, and Bunny is the offeree. If Bunny properly accepts the offer, then Chinda and Bunny will have a contract.

Only valid offers can result in contracts. Sections 2.3-2.6 of this Chapter discuss how many jurisdictions analyze whether an offer is valid, and whether it has terminated.

Section 2.3 explains that a valid offer must be:

(1) seriously intended (Section 2.3a);

(2) definite and reasonably clear (Section 2.3b); and

(3) communicated to the offeree (Section 2.3c).

Preliminary negotiations and invitations to negotiate are generally not valid offers, as Section 2.3d explains.

The idea of these three important requirements is to measure whether the offeror really wanted to make a legally binding agreement--a contract. For example, in the Case Study 25 situation, suppose Chinda had said to Bunny, "I may be able to give you this watch for $25," or "I can give you some watches for some money." Or suppose that Chinda had never communicated his offer to Bunny. In these cases, it seems unlikely that Chinda really wanted to make a binding agreement. And in these situations, at least one of the three requirements above would not be met. So there would be no valid offer.

Sections 2.4-2.6 explain how offers terminate--and are no longer valid. An offer that has been properly accepted cannot be terminated, since a contract has already been formed. But before a proper acceptance, an offer can generally terminate where:

(1) the offeror terminates the offer by revoking it (Section 2.4a), which may not possible in situations involving:
   (a) option contracts (Section 2.4b),
   (b) special statutes governing certain types of offers, such as those for the sale of goods or bids submitted to public agencies (Section 2.4c),
   (c) part performance in response to certain unilateral contract offers (Section 2.4d), or
   (d) promissory estoppel (Section 2.4e); OR

(2) the offeree terminates the offer by making:
   (a) a rejection (Section 2.5a); or
   (b) a counter-offer (Section 2.5b); OR

(3) the offer ends through other specific events or circumstances, such as:
   (a) lapse (Section 2.6a);
   (b) the occurrence of a condition specified in the offer itself (Section 2.6b);
   (c) the death or adjudicated incompetence of a party or person essential to the proposed contract (Section 2.6c);
   (d) the destruction of the specific subject matter of the proposed contract (Section 2.6d); or
   (e) a change in the law making the offer illegal (Section 2.6e).

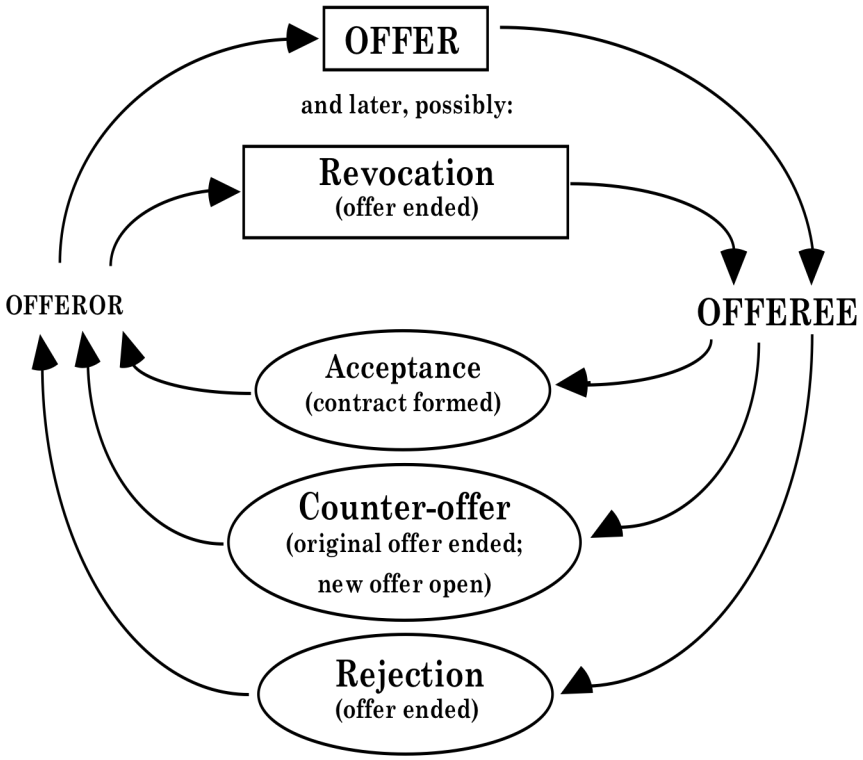
The basic idea behind these rules about the termination of an offer is that offers should not be open forever, or for an indefinite time. Offers provide the offeree with the ability to form a contract. This gives the offeree a lot of power. The law wants to limit this power, in order to protect the offeror, and to avoid the formation of a contract that would violate legal policy.

For example, in the Case Study 25 situation, suppose Chinda made his offer and Bunny did not respond right away. Many jurisdictions believe that, as long as Bunny has not made a proper acceptance, Chinda should generally have the right to revoke the offer, and that a rejection or counter-offer from Bunny should end the offer. In addition, many jurisdictions say that if too much time passes without any response from Bunny, or if the watch is suddenly destroyed by someone else, the offer terminates automatically.

This is because it would be unfair to Chinda and against legal policy for Bunny to have to power to accept in that kind of situation.

The following chart illustrates some of the basic possibilities where a party makes an offer.

Illustration: What Can Happen to an Offer



OR

Other Events End Offer:

Lapse
Condition
Death or Incapacity
Destruction of Specific Subject Matter
Illegality

*** ***WHY IS THIS IMPORTANT?*** Why are the rules about the validity and termination of offers important?

The rules about offers which are discussed in this Chapter are important for several reasons. One reason is that a valid offer is essential

for the creation of a contract. A contract cannot exist without an offer. The offer is the tool the offeror uses to tell the offeree--and the court--that she really wants to make a legally binding agreement, and what she would like the terms of that agreement to be. So it is crucial that parties and courts be able to decide whether a valid offer exists. The rules about offer discussed in this Chapter help parties and courts to determine that.

Another reason the rules about offers are important is that, as a practical matter, offers generally contain all the important terms that the parties will indicate about the proposed contract. Often, the response of the offeree to an offer is basically a "yes" or a "no." So offers often contain the whole contract except a "yes" from the offeree. This makes it very important to analyze offers to see not only if they meet the requirements discussed in this Chapter, but all the contract formation requirements discussed in this book.

2.3 An Offer Must Be Valid in Order to Form a Contract

As noted above, only valid offers can result in contracts. This Section explains how courts in many jurisdictions decide whether an offer is valid. Specifically, a valid offer must be:

(1) seriously intended (Section 2.3a);

(2) definite and reasonably clear (Section 2.3b); and

(3) communicated to the offeree (Section 2.3c).

Preliminary negotiations and invitations to negotiate are generally not valid offers, as Section 2.3d explains.

2.3a First Requirement: The Offer Must Be Seriously Intended

The first requirement for an offer to be valid is that it be seriously intended. This means that the offer must show that the offeror seriously intends to create a binding legal obligation--a contract. If the offer does not show this, then it is not valid, and it cannot result in a contract.

In many jurisdictions, whether an offer is seriously intended is generally judged by an objective, reasonable person standard. As explained in Chapter 1 ("Basic Aspects of Contract Law"), an objective standard is one that asks what reasonable persons in the same situation as the parties would think or do. With regard to whether offers are seriously intended, this standard means that the court asks whether a reasonable offeree would think that the offer was seriously intended to create legal obligations, based on the offer itself and the surrounding circumstances. If the answer is "no," then the offer is not valid. It does not matter whether the particular offeror really did--subjectively--want to make a contract.

*** ***CASE STUDY 26***

FACTS One day on the street, Rasy said to his friend Soriya: "Maybe we should trade our cars. If we do, you will probably have to give me some extra money." Soriya immediately replied: "I accept."

Rasy said there was no contract. But Soriya said there was a contract, and asked a court to order Rasy to obey it.

QUESTION OF LAW Did Rasy make a valid offer to Soriya in this case?

DECISION No. Rasy did not make a valid offer here, because Rasy's words do not show that he seriously intended to make one.

In order to be valid, an offer must be seriously intended to create legal obligations, based on an objective, "reasonable person" standard. In this case, Rasy told Soriya that "maybe" they should trade cars, and that if they did, Soriya would "probably" have to give Rasy some extra money. This does not show that Rasy seriously intended to make a contract. Obviously, Rasy was thinking about trading cars with Soriya. But his use of words like "maybe" and "probably" shows that he had not actually decided to do that yet. In fact, a reasonable person would probably say that Rasy was just starting to negotiate with Soriya. So in this case, there is no valid offer, and no contract.

In Case Study 26, Rasy's words were not seriously intended to create legal obligations. But suppose Rasy had written to Soriya: "I offer to trade you my car for your car and $500." That would probably be a valid offer, because it shows Rasy's serious intent to make a contract. So if Soriya properly accepted, it would form a contract.

Sometimes persons make offers in an emotional state which shows they do not have the serious intent to make a contract, even though the actual words or conduct showing the offer may seem to suggest that they do. For instance, parties may make an offer jokingly, or in great fear or anger. Many jurisdictions say an offer is not seriously intended where:

(1) the emotional state of the offeror suggests that the offer was not seriously intended, and

(2) the offeree had a reason to know that.

Again, this analysis is based on what reasonable person in the same circumstances would know. The reason for this rule is that it would not be fair to an offeror to hold her to an offer made in these situations. Of course, commercial transactions rarely occur in these kinds of circumstances. But consider the following Case Study.

*** ***CASE STUDY 27***

FACTS Hak and Machara were on a boat on the Tonle Sap. The boat capsized, and Hak fell out. Unfortunately, Hak could not swim. So he shouted to Machara in a very agitated voice, "I can't swim! I will give you my new house if you save me!" Machara risked his own life to save Hak.

Later, Hak thanked Machara and offered him a substantial sum of money. But Machara said he wanted the house, and asked a court for help.

QUESTION OF LAW Was Hak's offer to Machara seriously intended?

DECISION No. In this situation, there is no valid offer, because Hak's emotional state suggested that he did not seriously intend his offer to create a contract, and Machara had a reason to know that.

An offer is not valid where the offeror's emotional state suggested that she did not seriously intend her offer to create a contract, and the offeree had a reason to know that. In this case, Hak shouted an agitated offer to Machara as he was about to drown, offering to give Machara his house if Machara saved him. In this extreme emotional state of fear, Hak probably did not seriously intend to bind himself to give up his house. And Machara certainly had a reason to know that, based on the circumstances of the parties. So there is no valid offer, and no contract.

It might be argued that parties like Hak in Case Study 27 do have a serious intent to make a contract. Hak was obviously serious about wanting Machara to save him! However, the above rule may be based on the idea that what parties like Hak are really serious about is being saved--not making an enforceable agreement. Of course, in a situation like this, Machara might be able to recover under the doctrine of quasi-contract, as explained in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5.

On the other hand, sometimes an offeror makes an offer that she does not seriously intend--in her mind--but the offeree has no reason to know that. That is, a reasonable person would think that the offer was seriously intended. In that situation, the offer actually is "seriously intended" for the purpose of creating a valid offer! And so a contract can result. What the offeror really thought--in her own mind--does not matter.

*** ***CASE STUDY 28***

FACTS Yuon offered to sell Kileng a painting for $10, in a very serious voice. The painting was very unusual, and most people might say it was ugly and not worth much. In fact, the painting was worth $250, and Yuon was just trying to find out if Kileng knew the value of the painting, as a joke. Kileng did not know much about painting. But he did know about contracts, and he promptly accepted Yuon's offer.

QUESTION OF LAW Did Yuon make a valid offer in this case?

DECISION Yes. Yuon's offer will be considered to be seriously intended, and therefore valid, because Kileng had no reason to know Yuon was not serious.

Where an offer is not seriously intended but the offeror has no reason to know that, the offer will be considered seriously intended under the law. In this case, Yuon offered to sell Kileng a painting for much less than its real value as a kind of joke, just to see if Kileng knew about painting. Kileng accepted the offer. In this case, there was a valid offer. This is because Kileng had no reason to know--under an objective standard--that the painting was actually worth much more. And Kileng's acceptance means the requirement of real agreement is met. So this is probably a valid contract.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Sections 1.3d and 1.4g contain further discussion of how the law uses objective, reasonable person standards, and Section 1.5 discusses quasi-contract.

2.3b Second Requirement: The Offer Must Be Definite and Reasonably Clear

The second important requirement for a valid offer is that the offer must be definite and reasonably clear. The purpose of this requirement is make sure the parties and the court understand what is being agreed in the proposed contract.

As explained above, the offer generally contains the terms of the proposed contract, and it gives the offeree the power to create a contract by accepting it. But if the offer is not definite and clear enough in its terms, then the contract it proposes will not be definite and clear enough for the parties to follow and the court to enforce! An offer like that may be only an invitation to negotiate. So in that kind of situation, the law does not want the offeree to have the power to accept the offer and form a contract.

In order for an offer to be definite and reasonably clear, many jurisdictions say that:

(1) the offer must include the truly essential terms of the proposed contract;

(2) all the material (important) terms in the offer must be reasonably clear;

AND (3) the contract must be definite and reasonably clear at the time it is accepted--not at some later time.

The "truly essential" terms are those the parties themselves must decide, or there can be no contract. Courts cannot supply these for the parties. "Material" terms are those that are important, but that in some cases a court may be able to supply, if the parties have not included them. This will be further explained below.

There are certain special situations where offers do not have to be quite so definite and clear in order to be valid. Two of these situations are in certain cases where there is part performance in response to an offer, and in some jurisdictions with regard to sale of goods contracts. These situations are also discussed below.

(1) The Offer Must Include the Truly Essential Terms

A basic element of a definite and reasonably clear is that the offer include the truly essential terms of the proposed contract. These terms are more than just important--they are essential if the parties are to be able to follow the agreement, and for the court to be able to enforce it. Courts cannot supply (or imply) these terms based on the surrounding circumstances, as may be possible with some other material terms, such as price terms in sale of goods contracts. The possibility of implying terms will be discussed in more detail below and in Chapter 8 ("Interpretation of Contracts").

Which terms are truly essential depends on what type of offer the offeror makes. Different terms will be essential in different types of contracts. For example, in many jurisdictions, sale of goods contracts must include at least the identity and quantity terms. Land sale contracts should generally include at least the price and some description of the land being sold. And it would seem that employment contracts should include at least a starting date for the work and some way to calculate the rate of compensation. In all of these cases, it would not be reasonable for a court to try to supply these particular terms if the parties have not.

******* ***CASE STUDY 29***

FACTS Monivong Motors sent a purchase order to Samaki Steel Corp. ordering "grade B steel ingot at $100 per ton." Monivong had never bought steel from Samaki before. After Samaki received the purchase order, it sent a note to Monivong that said: "We accept your offer to purchase grade B steel at $100 per ton."

A few weeks later, before anything more happened between the parties, the market price for this type of steel dropped to $92 per ton. After this price drop, Samaki tried to enforce the agreement it had with Monivong. But Monivong said there was no contract.

QUESTION OF LAW Did Monivong and Samaki have a contract for the purchase of steel in this case?

DECISION No. There is no contract here because the offer Monivong made failed to include an essential term--the quantity of the steel--so it failed to meet the requirement that it be definite and reasonably clear.

For an offer to be valid, it must include at least the essential terms of the proposed contract, in order to be definite and reasonably clear. In this case, Monivong Motors offered to buy steel from Samaki Steel at $100 per ton. Samaki tried to accept this offer. But unfortunately, the offer failed to state the quantity of steel that Monivong wanted! In this case, the quantity is an essential term, as it is in other sale of goods contracts. There is no way a court could fairly and reasonably imply the quantity of steel Monivong wanted from the facts here. So the offer is not definite and reasonably clear. There is no valid offer, and no contract in this case.

(2) The Material (Important) Terms in the Offer Must Be Reasonably Clear

The second key element of the requirement that a valid offer by definite and reasonably clear is that the material (important) terms in the offer be reasonably clear.

*** **DEFINITION:** A **material term** in a contract is basically one that is important to a party's decision to make or not make a contract.

Of course, what terms are "material" will be different in every contract, since they will depend to some extent on the particular situation. But in general, terms that are often material include terms regarding price, identity, quantity, and place and time of performance. How clear is "reasonably clear" will also depend on the circumstances of each particular contract. That will be further discussed below.

First, it is important to understand how material terms compare to the "truly essential" terms described above. Courts cannot supply essential terms if the parties omitted them. All truly essential terms are material. But not all material terms are essential. Sometimes, courts can imply material terms the parties omitted, if that is reasonable based on all the circumstances. For example, this is often the case with a number of material terms in sale of goods contracts, such as price and delivery terms.

However, if contract parties try to include a material term, but fail to do so clearly enough that a court can interpret the term, the court cannot supply a reasonable term. This might violate the will of the parties, who tried to specify their own term, not a reasonable one. In these cases, the offer is generally not valid, and any agreement that results probably cannot be enforced. This is discussed further in Chapter 8 ("Interpretation of Contracts"), Sections 8.3j and 8.5a.

Material terms must be reasonably clear in order for an offer to be valid. This means they need not be completely or absolutely clear. They need only be clear enough that the parties and a court can understand the rights and duties are under the contract--what the parties have agreed. Of course, many contracts are very detailed and precise, such as important business agreements, and agreements for the sale of land. And it is a good idea to be as clear as is practical about all contracts, in order to avoid disputes and enforcement problems.

But it is not practical to ask parties to always be completely clear about every important term of every contract. This could be a real burden on the parties, and on important economic activity. Parties would have to stop many times a day and spend a great deal of time thinking of every possible area of confusion before making a moto taxi contract, or a contract to buy bananas. To require complete clarity could also mean that there would be very few valid offers, since it seems likely that some tiny lack of clarity could be found in almost any offer. So courts require only that material terms be reasonably clear.

What is "reasonably clear" depends on the particular circumstances in every contract. Consider the following two Case Studies.

*** ***CASE STUDY 30***

FACTS Mr. Phalkun offers to buy one ton of mangoes from Mr. Eng. The offer says that Mr. Phalkun will buy the goods at Mr. Eng's cost, plus "a nice profit" for Mr. Eng. Mr. Eng accepts the offer.

QUESTION OF LAW Is there a contract here between Mr. Eng and Mr. Phalkun?

DECISION No. The offer Mr. Phalkun made was not valid, because it was not clear enough about a material term: the price of the mangoes.

In order to be clear enough to be valid, offers must be reasonably clear about the material terms they include. In this case, Mr. Phalkun offered to buy mangoes from Mr. Eng for Mr. Eng's cost plus "a nice profit." The price term in this offer is not reasonably clear, because there is no fair and reasonable way to determine what a "nice profit" is. If the parties had simply stated no price term at all, the court might have been able to imply a reasonable one. But the parties tried to set their own term--and failed. The court cannot guess what the parties meant by a "nice profit." So this offer is not clear enough to be valid, and it did not form a contract.

*** ***CASE STUDY 31***

FACTS Mr. Sombok, the owner of a huge chicken production company, offered to sell 500 "chickens" each month at a certain price for the next year to

Mr. Cheep, the owner of a big new restaurant. Although Mr. Cheep had never done business with Mr. Sombok before, Mr. Cheep accepted the offer. The parties signed a contract for the chickens.

However, when the first truckload of 125 chickens arrived, Mr. Cheep said the chickens were not what he expected. Although the contract did not describe the specific kind of chicken to be provided, Mr. Cheep said he wanted only young chickens--and Mr. Sombok had delivered old chickens instead! So Mr. Cheep refused to accept and pay for the chickens. Mr. Sombok, however, insisted that he had delivered the chickens in compliance with the contract. The parties argued back and forth for several weeks. During that time, Mr. Cheap did not serve any chicken in his restaurant. As a result, he lost a lot of money, and possibly some customers also.

Now Mr. Sombok and Mr. Cheep ask the court for help. On one side, Mr. Sombok asks the court to order Mr. Cheep to pay him the contract price of the chickens, plus interest. On the other side, Mr. Cheep asks the court to order Mr. Sombok to pay compensation for the damage caused when Mr. Sombok delivered the wrong kind of chicken. After hearing the claims of the parties, the judge asks her research assistant to help her find out if the contract is clear enough to be enforced at all, and if so, what it means.

QUESTION OF LAW Was Mr. Sombok's offer definite and reasonably clear enough to be valid, and result in a contract?

DECISION Yes. The offer and resulting chicken sale contract between Mr. Sombok and Mr. Cheep were definite and clear enough, because the material term "chicken" was reasonably clear.

In order for an offer to be valid, and to result in a contract, the offer must be definite and reasonably clear. Part of this analysis is that the offer must be reasonably clear--but not absolutely clear--about the material terms it includes. What is "reasonably clear" depends on the particular circumstances of every case.

In this case, Mr. Sombok offered to sell a certain quantity of "chickens" to Mr. Cheep at a certain price. Mr. Cheep accepted the offer. "Chicken" was the subject of the offer and contract, and obviously a material term: the identity term. But unfortunately, the offer did not specify exactly what kind of chicken. It only said "chicken." Now the parties claim they had different ideas about what the material term "chicken" meant in their contract. So the basic issue in this case is: what is "chicken?" Specifically, the court must decide if the word "chicken" was definite and reasonably clear enough in Mr. Sombok's offer. If it was clear enough, then there was a contract between the two parties. In that situation, the court would also have to decide if Mr. Sombok delivered "chickens" according to the contract. However, if the court decides that the agreement's reference to "chicken" was not reasonably clear, then the court will be unable to enforce the agreement between the parties.

When parties disagree about the meaning of a term in their contract, courts apply a number of rules of interpretation to see if they can find the meaning. Many jurisdictions first ask whether they can find one subjective meaning that the parties shared--a meaning that the particular parties in the case actually had in their minds. If courts can find such a meaning, they enforce that meaning. If they cannot find such a meaning, then the courts apply a number of objective rules of interpretation, to see if they can find a meaning based on what reasonable parties in the same situation would likely have meant. There are many rules to help courts do this, and they will be discussed in detail in Chapter 8 ("Interpretation of Contracts").

In this case, it appears that the parties did not have the same subjective meaning about what chickens meant. Mr. Sombok's offer did not define the word "chicken." Mr. Sombok says he thought it meant any chickens--old or young. Mr. Cheep says he thought it meant young chickens, not old chickens. Assuming neither party knew or had a reason to know of the other party's subjective understanding of "chicken," the court would probably turn to objective rules of interpretation. These rules include an analysis of the ordinary meaning of chicken in situations like these. To find this, a court might examine the ordinary meaning, including the definition of "chicken" in dictionaries and technical manuals. A court might also examine the circumstances surrounding the contract, such as any prior transactions between the parties (the "course of dealing"), and any relevant trade practices ("trade usages"). Many other rules of interpretation might help the court also.

Suppose the court finds that the word "chicken" is clearly defined in the dictionary, and also in relevant Ministry of Agriculture regulations. Neither definition says anything about "young" chickens or "old" chickens. With respect to the circumstances surrounding this transaction, this was the first time Mr. Sombok and Mr. Cheep had done business together. So there was no course of dealing between them that could show that they probably shared a particular idea about the word "chicken." However, the court finds the ordinary trade practice in the restaurant business is that if someone wants a special type of chicken--such as young, or large--that person must specify the exact type clearly in the contract. Mr. Cheep did not do that.

So in this case, based on objective rules of interpretation, the word "chicken" does not seem to mean "young chicken." It would appear to mean any chicken, or at least any chicken that was fit to eat. In this situation, the court would probably find that the material term "chicken" was reasonably clear enough in Mr. Sombok's offer and in the contract. And Mr. Sombok complied with the contract by delivering chickens, even though they were not as young as Mr. Cheep seemed to want. If Mr. Cheep had really wanted a special kind of chicken, such as young chickens, he should have said so in the contract. In this situation, Mr. Cheep has breached the contract by failing to pay for the chickens. The court will award Mr. Sombok a remedy for the harm this breach caused.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts") contains further discussion of contract interpretation, including how courts can interpret contracts based the ordinary meaning (Section 8.3f) and surrounding circumstances (Section 8.3h), how courts can supply certain terms if the parties did not (Section 8.3j), and how agreements probably cannot be enforced if a material term cannot be interpreted (Section 8.5a).

(3) The Offer Must Be Definite and Reasonably Clear at the Time It Is Accepted

One final aspect of the rule that offers must be definite and reasonably clear is that offers must meet this requirement at the time they are accepted. That means they cannot be made sufficiently definite and clear at some time after a contract is formed. At the time of acceptance, the offer must be clear enough--by containing the essential terms, and being reasonably clear about the material terms it includes--or else no contract can be formed.

The phrase "an agreement to agree is no agreement" summarizes this general principle of contract law. Parties do not generally create a contract when they just agree that at some future time they will make a contract, or that they will make a contract based on terms that they will have to agree about later. In certain situations courts may imply a duty of good faith and fair dealing at the contract negotiation stage. That may limit to some extent a party's right to not agree later, as will be further discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3i. But the general rule remains.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3j explains how many jurisdictions say the duty of good faith and fair dealing is part of every contract.

*** ***CASE STUDY 32***

FACTS Ratana wrote to Navy: "I offer to lease your building at 13333 Monivong Boulevard for one year at $2,000 per month, with further construction, alterations and floor layout to be mutually agreed upon later." Navy accepted the offer. But later, Ratana changed her mind and refused to lease the building.

QUESTION OF LAW Was Ratana's offer definite and reasonably clear enough to be valid and form a contract with Navy?

DECISION No. Ratana's offer was not definite and reasonably clear enough to be valid, because it left material terms about further construction and alterations to be "agreed upon later."

Offers must be definite and reasonably clear enough at the time they are accepted--not at some later time--or else they are not valid, and no contract is formed. In this case, Ratana's offer to rent Navy's building stated

the essential terms. But it said that certain material terms about further construction and alterations to the building would be "mutually agreed upon later." This cannot be a valid offer, because it was not definite and reasonably clear when Navy tried to accept it. In this kind of situation, the court cannot know what the parties might have agreed upon later. So no contract was formed here.

However, it is possible for an offer to be definite and reasonably clear where it offers the offeree a choice about which terms to accept. For example, suppose Ratana's offer in Case Study 32 had not discussed construction or alterations. However, suppose the offer had given Navy the choice of renting Ratana the building at 13333 Monivong Boulevard for $2,000 per month, or renting him the building at 22222 Norodom Boulevard for $3,000 per month. That could be a valid offer. It is not certain at the time of the offer which of the two options Navy will select. But the parties and a court could determine how any resulting contract should be performed. Both potential options are clear. Whatever Navy chooses to do, the parties will know how to proceed. That was not true of the situation in Case Study 32.

*** ***WHY IS THIS IMPORTANT?*** What are the practical effects of the rule that requires offers to be definite and reasonably clear in order to be valid?

The most basic reasons for this rule are that parties must know what the contract requires in order to perform it, and courts must know what it requires in order to enforce it. Parties cannot be expected to follow a contract that is not clear. And such a contract would be likely to lead to many disputes. If such disputes came to court, the judge would also have no way to tell how to enforce the contract. Courts cannot and do not wish to create contracts for the parties. In a free market economy, it is generally the responsibility of the parties to create their own contracts, within certain limits. Otherwise, there could be a great deal of uncertainty and economic inefficiency.

So the law requires that, in order for offers to be valid, they must at least include the essential terms, and be reasonably clear about all the material terms they include, at the time they are accepted. If these requirements are not met, courts will not enforce any resulting agreement.

(4) Two Special Situations Where the Offer May Not Need to Be Quite So Definite and Clear: Part Performance and Sale of Goods Exceptions

In many jurisdictions, there are certain special situations where offers need not be quite so definite and clear as they must be in general. These rules exist in order to achieve justice or economic efficiency in special situations where the regular rules might not do that.

Two important situations where offers need not be quite so definite and clear are:

(1) where there has been part performance in response to the offer in certain situations; and

(2) in sale of goods contracts in some jurisdictions.

These special situations are briefly discussed below.

(1) Part Performance -- In some situations, an offeror makes an offer that is not really definite and reasonably clear under the rules discussed above, but the offeree actually performs in response to the offer in a reasonable way, perhaps with some performance, or at least a failure to object, by the offeror. In these situations, a contract may actually be formed based in part on the later conduct of the parties, even though the original offer was not really definite and reasonably clear.

What happens here could be analyzed in different ways. The offeree's performance could be considered an acceptance, or a new offer the original offeror accepts by her conduct. This could also be considered a way of interpreting the contract based on the "course of performance" of the parties, which is one of the important surrounding circumstances courts use to interpret contracts generally. That will be further discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3h. But the basic idea here is that the performance of the offeree or both parties appears to supply whatever definiteness and clarity are missing in the original offer.

*** ***CASE STUDY 33***

FACTS Kim San says to Chhat, "I offer to employ you at $20 a day." Chhat accepts this offer, and then performs construction work for Kim San at Kim San's house for the next six days. Kim San supervises this work and does not object to it. But he says there was no contract between him and Chhat.

QUESTION OF LAW Do Kim San and Chhat have a contract that requires Kim San to pay Chhat $20 per day for the six days Chhat worked?

DECISION Probably. Even though Kim San's offer was probably not definite and clear enough by itself, the course of performance of the parties here probably supplied the definiteness and clarity the original offer lacked.

Offers may not need to be as definite and clear as usual where the course of performance of the offeree, and possibly the offeror, provides the definiteness and clarity the original offer lacks. In this case, Kim San offered to employ Chhat for $20 per day. This offer was probably too indefinite and unclear to be valid under the regular rules discussed above, since it failed to indicate what the work would be, when it would start, and possibly other essential terms. However, Chhat's performance in response to the offer,

along with Kim San's supervision of the work and failure to object--the course of performance--probably supplied the definiteness and clarity lacking in the original offer. So a court would probably say that Chhat and Kim San did have a contract for these six days of work at $20 per day, and that Kim San now has the duty to pay Chhat $120.

(2) Sale of Goods -- Another situation in which many jurisdictions say offers need not be quite so definite and clear is with regard to sale of goods contracts. Commercial laws in some jurisdictions (such as the Uniform Commercial Code in the United States) do not require sale of goods contracts to be so definite in certain ways.

In particular, some commercial laws say that a court can sometimes imply reasonable terms--even certain material terms--in sale of goods contracts where the parties did not specify them. Such laws try to account for how parties actually do business. Parties do not always have the time or the desire to be so clear about some of their contract terms in the fast-paced commercial setting in which many sale of goods contracts occur. Rules like this are designed to promote greater economic activity.

For example, sometimes sellers and buyers of goods do not state price, delivery, or payment terms when they make their offers. They may not have time, or they may simply wish the law to imply a reasonable term. The law will often do so, as long as the offeror has included the truly essential terms, which are generally the identity and quantity of the goods. Again, this will be further discussed in Chapter 8.

*** ***CASE STUDY 34***

FACTS Neam wants to buy some special tires for his new car. Unfortunately, none of the tire shops in the city have any of those particular tires left to sell him.

But Saray, who operates an import-export trading company, tells Neam that inside of one month he can find and get the tires that Neam wants. Saray then offers to find and deliver five of the special tires to Neam. After thinking about Saray's offer for two days, Neam accepts.

QUESTION OF LAW Was Saray's offer definite and clear enough to be valid and form a contract with Neam?

DECISION Yes. Even though Saray's offer seems indefinite and unclear because it did not include a price for the tires, courts in many jurisdictions will generally imply a reasonable price for sale of goods contracts.

In many jurisdictions, offers for sale of goods contracts may not need to be quite so definite and clear as other offers. This is because courts

may be able to imply certain reasonable terms even where the parties did not actually state them.

In this case, Saray offered to sell Neam some tires. But he included no price term. Even though this offer might normally be too indefinite and unclear, it is not too indefinite and unclear for a sale of goods contract like this. In this situation, the court can supply a reasonable price for the tires, which will generally be a reasonable price at the time for delivery. So when Neam accepted Saray's offer to sell him the tires, he formed a contract.

*** ***CASE STUDY 35***

FACTS Reaksa, the manager of the new World Trade Office Tower, and Peou, the owner of the Fine Furniture Co., are very busy. After a fast conversation together, Reaksa offers to buy 100 "Big Boss" brand office desks and chairs from Peou's company. Peou accepts. Neither Reaksa nor Peou mentions any other terms, though they do both send signed notes confirming the terms they did discuss.

But when Peou calls Reaksa one week later to tell him that all the desks and chairs have arrived, Reaksa denies any obligation to take or pay for them! He says the agreement cannot be enforced because it had no price or delivery terms.

QUESTION OF LAW Did Reaksa make a valid offer even though he said nothing about price or delivery?

DECISION Yes. Reaksa's offer for the furniture was valid even though it did not include price or delivery terms, because courts in many jurisdictions can imply such terms.

Many jurisdictions do not require sale of goods offers to be quite so definite and clear as others. That is because they will imply reasonable terms in many situations where the parties did not state them.

In this case, Reaksa offered to buy a certain amount of furniture from Peou for a certain price, but the offer included no price or delivery terms. The offer is still valid. This is because the court can imply a reasonable price, and will probably imply that delivery should occur within a reasonable time at Peou's place of business. And the parties included the truly essential terms: the identity (Big Boss desks and chairs) and quantity (100) of the goods. So in this case, the offer was valid, and a contract was formed.

In addition, there are two special types of sale of goods contracts that some jurisdictions say need not even be so definite about the quantity term. These are output contracts and requirements contracts. An output contract occurs where a seller of goods agrees to sell all of a certain kind of goods that that seller produces in a certain period to a specific buyer.

A requirements contract is one where a buyer of goods agrees to buy all of a certain kind of goods that that buyer needs in a certain period from a specific seller. Of course, in these cases, it is possible that no goods at all will be produced by the seller or required by the buyer. So the agreements seem indefinite as to quantity.

But courts will generally enforce these contracts anyway. In a way, such contracts are reasonably definite in the sense that the parties have said exactly the quantity they mean: whatever is actually produced or required! This is more specific than omitting the quantity term, or saying "whatever I might choose to sell," or "whatever I might choose to buy." In addition, the parties to these contracts are usually businesses that have calculated their needs and abilities, based on past situations. But despite this, sometimes such parties simply cannot say exactly how much they will produce or require in a given period, because of market conditions or other factors. These special contracts allow such parties the flexibility they need. And courts will not enforce these contracts if the amount actually produced or required turns out to be "unreasonably disproportionate" to any estimate the parties made, or if there is no estimate, disproportionate to any normal comparable quantity. Chapter 3 ("Consideration"), Section 3.5d explains output and requirements contracts in more detail.

*** ***WHY IS THIS IMPORTANT?*** Why do commercial laws in many jurisdictions say offers for sale of goods contracts can be less definite and clear than offers in other kinds of contracts?

Commercial laws have several basic goals. One is to try to protect the expectations of parties who make commercial contracts. Another key goal is to try to promote of commercial activity, including the purchase and sale of goods.

The "sale of goods exception" tries to accomplish both of these goals by recognizing that many buyers and sellers of goods make contracts every day without specifying some terms that are important. In particular, as described in Case Studies 34 and 35 above, parties in sale of goods contracts often omit information about price, payment and delivery. And they may not even be specific about quantity, as in output and requirements contracts. Obviously, these terms are important in sale of goods contracts.

But even though the parties in sale of goods contracts often omit such terms, such parties generally understand that the terms will be implied to be reasonable ones under the circumstances. For instance, parties who do not say anything about a time and place of delivery of the goods probably expect that the buyer will get the goods at the seller's place soon. So commercial laws about contracts imply such normal expectations. And courts apply those commercial laws in order to try to fulfill the normal expectations of the parties. This also encourages sales transactions, because the result is that buyers and sellers of goods can make more contracts. And courts will often enforce

those contracts even though some of the material terms are missing. In this way, commercial law tries to protect contracts and promote commercial activity.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3d contains further discussion of how the law can sometimes imply contract terms; Chapter 3 ("Consideration"), Section 3.5d explains output and requirements contracts; and Chapter 8 ("Interpretation of Contracts"), Section 8.3 discusses rules of contract interpretation, including the course of performance (Section 8.3h) and how courts can supply certain terms (Section 8.3j), and Section 8.5a discusses what courts do when a material term cannot be interpreted.

2.3c Third Requirement: The Offer Must Be Communicated to the Offeree

The third key requirement for an offer to be valid is that it is communicated to the offeree. It is unlikely that an offeror really wanted to make a contract with someone if the offeror never communicated her offer to that person! But when an offeror does communicate her offer to another person, it is strong evidence that the offeror did want to make a contract with that person. So it is a key rule of contract law that an offer is not valid--and a contract cannot be formed--until the offeror has communicated the offer to the offeree. So each offeror must make sure that her offer is communicated to the offeree she wants, in the way she wants.

This rule also protects the offeror, by giving her the freedom to choose with whom she wants to make a contract, as well as the time and manner in which she will communicate the offer to that other party. In general, "the offeror is the master of her offer," as an old contract law saying goes.

*** ***CASE STUDY 36***

FACTS Mr. Khemara dictated a letter to his secretary. In the letter, Mr. Khemara said he was offering to sell to Ms. Theary some stock he had in an oil company. But before Mr. Khemara mailed the letter to Ms. Theary, he heard on the radio that the company had made a huge new discovery of oil. This would cause the stock's value to go up.

Ms. Theary also heard the news. And she also learned about the unmailed letter from Khemara's secretary, who was not authorized to make offers for Khemara. Ms. Theary immediately called Khemara on the telephone and tried to accept his offer--even though he had not communicated it to her.

QUESTION OF LAW Was Mr. Khemara's letter a valid offer which could create a contract when Ms. Theary accepted it?

DECISION No. Mr. Khemara's offer was not valid because he had never communicated it or directed that it be communicated to Ms. Theary.

An offer is not valid unless the offeror has communicated it, or directed that it be communicated, to the offeree. In this case, it was clear that Mr. Khemara had the idea to make an offer to sell some oil company stock to Ms. Theary. But his dictation of the letter to his secretary was only one step leading to his actual communication of the offer. Khemara never finished the process of communicating his offer to Ms. Theary, because Khemara never authorized his secretary to make the offer for him. Only the offeror can decide when and how to make his offer. So even if an offeror (like Mr. Khemara) writes an offer, and the correct offeree (like Ms. Theary) hears about it, the offer is not valid until the offeror actually communicates it, or directs that it be communicated. That did not happen in this case. So Mr. Khemara's offer was not valid, and Ms. Keary could not accept it. No valid offer = no contract.

A related rule about offerees is that only the specific offeree or offerees the offeror choose(s)--the "intended offeree(s)"--can generally accept the offer. There can be multiple offerees, but they must be chosen by the offeror. In general, no one else can create a contract with the offeror just by accepting her offer. This is because in free market jurisdictions, people generally have a right to choose the people with whom they deal. The law in such jurisdictions often calls this right the "freedom of contract." This rule is actually part of the rules about acceptance, and it will be discussed in much more detail later in Section 2.8 of this Chapter.

*** ***CASE STUDY 37***

FACTS Sanna sent a letter to Bun Rouen. In the letter, Sanna clearly offered to sell her house to Bun Rouen for $50,000. Although Bun Rouen himself did not want to buy Sanna's house, he told his friend Kek about her offer. Kek immediately delivered a signed letter to Sanna which said: "I accept your offer."

QUESTION OF LAW Is there a contract between Sanna and Kek?

DECISION No. Sanna's offer was valid, since it was communicated to her intended offeree Bun Rouen, but no other party (like Kek) could accept it.

In general, only the intended offeree can accept an offer. In this case, Sanna had communicated her offer only to Bun Rouen, and it was clearly intended only for Bun Rouen--not Kek. So it is clear that she intended to make a contract with Bun Rouen, and no one else. Kek cannot make a proper acceptance of this offer. So there is no contract here.

2.3d What Are Not Valid Offers: Preliminary Negotiations, and Invitations to Negotiate or Make Offers

It is important to stress certain types of activities that do not generally meet the above requirements for a valid offer. This is because certain activities may be easily mistaken for valid offers, even though they are not.

Two important groups of activities that some people may view this way but which are not generally valid offers are:

(1) preliminary negotiations, and

(2) invitations to negotiate or make offers, such as marketing activities and bid solicitations.

The reason for this rule is that people involved in such activities are generally just starting to think about making a contract. Or perhaps they just want to know if others are interested in making a contract with them. In preliminary negotiations, the parties are just talking about possibilities for a contract. In invitations to negotiate or make offers, one party is basically searching to find people who might want to make a contract with her. In both cases, one or more of the parties may communicate ideas and possibilities for a contract. But they are not ready to make a contract yet. So such activities are really not offers, though they may sometimes appear to be. Instead, they are more like "pre-offer" activities.

*** ***WHY IS THIS IMPORTANT?*** What is the practical effect of the general rule that preliminary negotiations and invitations to negotiate or make offers are not offers?

As explained earlier, if there is no offer, there can be no contract. So when jurisdictions say that activities such as preliminary negotiations and invitations to negotiate or make offers are not themselves "offers," the practical effect is that the parties involved in those activities must do more if they really want to create a contract. If they do no more than just negotiate or make invitations, there is no contract between them. This is true even if one of the parties says "I accept," because there was no "offer" for that party to accept! These rules are important to understand, because preliminary negotiations and invitations to negotiate or make offers--such as marketing activities and bid solicitation--are so common in modern commercial activity.

(1) Preliminary Negotiations

Before parties actually make a contract together, they often discuss what they are looking for, and the potential terms of the contract. These are preliminary negotiations.

Preliminary negotiations are not offers unless they meet all the requirements discussed above, such as showing a serious intent to make

a contract and that the proposal for a contract be definite and reasonably clear. Statements like "I'm interested in this," or "I plan to do that," or even "I think I might be able to give you $100," do not usually meet these requirements. So in order for a valid offer to exist, there must be more than just preliminary negotiations.

*** ***CASE STUDY 38***

FACTS Mouly writes a letter to Sovannarit. The letter says: "I am planning to sell my house for $60,000. I would really like to get rid of it." Sovannarit immediately writes a reply saying: "I accept and will buy your house at the price stated in your letter."

QUESTION OF LAW Did Mouly make a valid offer which Sovannarit could accept to make a contract?

DECISION No. There was no offer here--only preliminary negotiations--because Mouly was only discussing the possibility of selling his house.

Preliminary negotiations are not usually valid offers. In this case, Mouly merely expressed a plan or intention to sell his house. By itself, a wish or a plan is not a valid offer which can create a contract when another party accepts it. A party cannot "accept" something that was never even offered to him! So Mouly has actually made no valid offer here, though he may wish to engage in further discussions with Sovannarit, and perhaps even make a contract at some later time. But for now, no offer = no contract.

(2) Invitations to Negotiate or Make Offers, Such as Marketing Activities and Bid Solicitation

Other types of activities that may look like offers, but generally are not offers, are invitations to negotiate or make offers. Many public communications may seem to be real offers, and may even use the word "offer." However, the law does not consider them to be offers whose acceptance creates a contract unless they meet all the requirements for a valid offer. If they do not, they are probably only invitations which ask the public to negotiate or to make offers.

There are many important types of "invitations to negotiate or make offers." Two of the more common ways that parties make such "invitations" are through:

(1) marketing activities, including general advertising, window displays, price lists, price tags, catalogs, and circular sales letters;

AND (2) formal solicitation of bids.

These will be discussed in more detail below.

(1) Marketing Activities -- Perhaps the most common types of "invitations" are general advertisements, window displays, catalogs, price lists, price tags and circular sales letters. Generally, such communications describe or display a product or service the seller wants to sell, and the price at which she wants to sell it.

The reason most marketing efforts are not valid offers is that they are usually too general. In particular, marketing efforts are usually more general than valid offers in one or both of the following ways:

(1) unlike most valid offers, most marketing efforts are directed at the general public (not to any specific party); and

(2) unlike the situation with valid offers, the goal of most marketing efforts is to invite parties to negotiate a sale.

These two key differences are explained more fully below.

(a) Marketing efforts like advertisements are usually directed at the general public, whereas most valid offers are directed at particular parties. If an advertisement or other marketing effort is not specifically intended for any particular party or parties, but at the general public, then it is generally only an invitation to negotiate, not a valid offer. So even if someone tries to accept such an invitation, the party who made the invitation may generally refuse to agree. This is because the invitation was probably not an offer. In fact, it was probably the response of the party who received the invitation that was the offer.

*** ***CASE STUDY 39***

FACTS Dr. Sethyk typed a document which said, in large letters: "For sale: My house at 33333 Sihanouk Boulevard, for $100,000." After making 100 copies of the letter, Dr. Sethyk posted and circulated the copies at the medical school where he taught, at the hospital where he worked, and at many places near his house. Soon he received a letter from Polita which said: "I accept your offer."

QUESTION OF LAW Did Polita's letter create a contract with Dr. Sethyk?

DECISION No. Polita's letter did not create a contract because Dr. Sethyk's communication was actually a circular sales letter--an invitation directed at the general public--and not a valid offer.

Marketing activities such as circular sale letters are generally not valid offers, but only invitations to negotiate. In this case, Dr. Sethyk distributed 100 copies of a document advertising the sale of his house. This was a circular sales letter. Dr. Sethyk distributed this document in order to invite as many people as possible to contact him about buying his house. The document was clearly not directed at any one specific person or specific group of persons.

So it was only an invitation to negotiate, and not a valid offer. Polita could not "accept" it. No offer = no contract.

Parties like Polita in Case Study 39 do not create contracts just by trying to "accept" the marketing invitations of parties like Dr. Sethyk. In fact, the invited party's attempted "acceptance" is probably just an offer which she makes to the party who made the marketing effort! So when a party makes a marketing effort to the public, and someone tries to "accept," that person's attempted "acceptance" is generally an offer. Then, the party who made the marketing effort can decide to accept or reject the other party's offer. If the marketing party decides to accept it, then there is a contract. But if that party rejects the offer, then there is no contract.

*** ***WHY IS THIS IMPORTANT?*** Why are most marketing efforts not valid offers, but only invitations to negotiate or make offers?

It appears that most marketing efforts are not considered offers primarily in order to protect the marketer or advertiser. Marketers could have problems if they were bound by every attempt by a member of the public to buy the advertised product or service. This could lead to many more offerees than the marketer wanted, and could cause her real problems. This possibility could deter business people from doing marketing--since they would be afraid that they would become legally obligated to vast numbers of people every time they did any advertising! In the end, that could restrict the free flow of information about products in the marketplace, and limit economic activity.

However, reward advertisements are an important exception to the above rule about public offers. As noted in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b, in the discussion of common law unilateral contracts, advertisements offering rewards generally are valid offers, even though they are directed at the general public. This is because reward offers--unlike most other advertisements--usually are very clear and definite about what they offering. Most ask for the performance of one specific act, not further negotiation. The performance of the act is generally the acceptance. Often, this act can or will be performed only once. So in most of these situations, there is less danger that more offerees will accept the offer than the offeror really wanted.

*** ***CASE STUDY 40***

FACTS Vannath put an advertisement in a newspaper which said: "I will pay $1,000 to the first person who gives me information which leads to the arrest and conviction of the person who set fire to my property." A clever university student named Pon saw the advertisement. He decided to investigate the matter in order to get the reward. As a result of evidence that Pon discovered and provided to Vannath, the police arrested a man named Chhum.

At the end of his trial one month later, Chhum was convicted of the crime of arson. But when Pon demanded the $1,000 reward from Vannath, she refused to pay him.

QUESTION OF LAW Was Vannath's advertisement a valid offer, which Pon accepted by performing the act requested?

DECISION Yes. Vannath's advertisement was a reward offer which promised to pay $1,000 to the first person who performed a certain act, so it was a valid offer which Pon accepted when he performed that act.

Although most advertisements are not valid offers, advertisements including reward offers often are. This is because a person who advertises a reward often does not want to negotiate, but instead wants only one specific thing: the requested act.

In this case, Vannath made a reward offer requesting a specific act: the provision of information leading to the arrest and conviction of the arsonist who burned her property. This was a specific offer which only one party could accept. Pon performed the specific act Vannath requested in her offer. This performance was an acceptance of Vannath's offer. So Vannath must pay the $1,000 to Pon.

(b) Most marketing efforts are intended only to invite parties to negotiate with the advertiser, whereas valid offers generally enable parties to accept immediately. People and organizations usually advertise in order to attract and negotiate with others who are interested in what they are advertising. This goal is usually implied--and is often expressed--in the various forms of marketing, including window displays, catalogs, price lists, price tags and sales letters.

*** ***CASE STUDY 41***

FACTS The Happy Shoe Store put a pair of shoes with a price tag of $8.95 in the shop window. Sochivin saw the shoes and said that he accepted the Store's offer and would buy them at that price.

But the price was a mistake. The price tag should have said $18.95. So the owner of the shop told Sochivin that $8.95 was not enough, and if he really wanted the shoes, he had to pay the correct price of $18.95. Then the owner walked to the shop window and changed the price tag to the higher price.

QUESTION OF LAW Was the $8.95 price that the shop advertised a valid offer that Sochivin could accept?

DECISION No. The window display was not a valid offer, but merely an invitation to Sochivin (and the rest of the world) to make an offer for the shoes.

Advertisements are generally not valid offers, but merely invitations to negotiate or make offers. In this case, the erroneous $8.95 price tag in the Happy Shoe Store was not an "offer" to Sochivin or to anyone else. In fact, it was only asking for offers related to those shoes, probably at that price. It was an invitation to negotiate. So neither Sochivin nor anyone else could "accept" it. And the Shoe Store need not sell the shoes for $8.95.

The result in Case Study 38 above would be the same even if the price tag for the shoes had been correct. It does not generally matter if the advertised price was right or wrong, or even if the seller really intended to sell her goods at all. There is no contract because a mere invitation to negotiate--such as a price tag on goods--by itself is not an offer.

Generally, this rule also applies to newspaper, radio, television, and electronic advertisements. For example, a "FOR SALE" advertisement in a newspaper is usually just an invitation to negotiate. It is not an "offer" to every reader of the newspaper. It would be impossible for the seller if everyone who read that newspaper could create a contract with the seller just by saying "I accept!" So even though the seller almost certainly wants to sell the advertised item, and even though she probably has the advertised item, she probably has no contract obligation to sell it.

On the other hand, in practice most sellers like the one in Case Study 41 do accept offers that parties like Sochivin make in response to advertisements. Most sellers really do want to sell the goods they advertise, at the advertised price. And sellers normally try to avoid damaging their business reputations by changing goods or prices after they are advertised. Consumers do not like this, and in most free market jurisdictions, businesses that do this do not do very well. In addition, even though contract law may allow such conduct by sellers, many jurisdictions have other types of laws--including criminal and consumer protection statutes--which prohibit false advertising and other fraudulent conduct by sellers. A seller who regularly attracted customers with low prices, then regularly switched them to higher prices when customers tried to buy, might violate such laws.

(2) Formal Solicitation of Bids -- When a party asks for or "solicits" bids--offers--that party is obviously just looking for offers. Bid solicitation occurs when a government or other party requests bids for various projects, such as the construction of a new highway or power plant, or the management of a hospital or university. These bids are the offers. So the request for bids is just an invitation to parties to make offers to the government. Many private persons and firms use a similar bid solicitation procedure when they want to complete a large construction or management project.

Of course, the party soliciting bids does not make a contract with each company that submits a bid! Instead, the bid solicitor carefully analyzes all the bids to see one which is the best, based on all the relevant circumstances, including price, experience, and other factors. Then it chooses one of the bids--

that is, it accepts one of the offers. For very large projects, it may accept a number of bids, each for different work or materials. In any case, it is the party soliciting bids--not the companies submitting bids--who has the power to make a contract in such cases.

Generally, procurement statutes closely regulate how a government must conduct this bidding process. Most jurisdictions require the government to advertise widely to get competitive bids for the performance of such projects. To do this, the government normally publishes newspaper advertisements and detailed information circulars about the project. In these documents, the government asks private companies to submit bids to do the work. For substantial projects, these statutes generally require the government to choose the lowest practical bid, assuming it chooses any, except in special circumstances. Such statutes forbid bribes in the bidding process, since corruption can lead to poor quality work done by parties who did not deserve to win the contracts. The private party whose bid is chosen then has the duty to do the job, and the government has the obligation to pay the bid price.

*** ***CASE STUDY 42***

FACTS The Ministry of Education decided to build a big new law school. The Ministry advertised in several major newspapers and on radio for bids from construction companies. The Angkor Empire Construction Corporation and Khmerco were two of many companies that submitted bids to the Ministry according to the proper bidding procedure.

The Ministry chose the bid of Khmerco, and signed a contract with that company. But Angkor Empire sued the Ministry, claiming that the Ministry had violated its contract with Angkor Empire.

QUESTION OF LAW Did Angkor Empire create a contract when the Ministry received its bid to consider?

DECISION No. Angkor Empire's bid could not create a contract because it was only an offer--made in response to the Ministry's invitation for such offers--which the Ministry was free to accept or reject.

Bid solicitation is a process in which governments or others invite parties to make bids--offers--to perform work or supply materials for various kinds of important projects. In this case, the Ministry of Education solicited bids for the construction of a new law school. When the Ministry solicited the bids, it did not make a valid offer about the construction job--it invited offers. So a bid which any company submitted in response could not possibly be an acceptance which created a contract with the Ministry. Obviously, the Ministry was looking for many bids to consider, in order to choose the best one.

When Angkor Empire, Khmerco, and the other construction companies submitted their bids, the Ministry received the bids only to consider them.

The Ministry had the right to accept or reject the bids. So between the Ministry and Angkor Empire, there was only the offer (bid) from Angkor Empire. The Ministry decided to accept Khmerco's bid, and not Angkor Empire's bid. The Ministry had no duty to accept Angkor Empire's offer, and it never did. So there was no contract between these parties.

*** ***WHY IS THIS IMPORTANT?*** What is the purpose of the rule which says that parties generally can solicit and receive bids without becoming obligated to the bidder?

In general, this important rule gives governments and other parties the freedom and flexibility they need to get and analyze good offers for substantial projects. The rule recognizes two basic aspects of modern commercial activity.

First, the rule recognizes the way most people and groups actually do business: they look around for the best price. A simple, everyday example is a person who wants to buy something in the market but first walks around and asks different sellers what their prices are.

The second aspect of modern commercial activity is the frequent need to ask for detailed offers for the performance of complex jobs or services. Case Study 42 is a good example. Bid solicitation enables governments and others to do all this in an organized, efficient way. If such parties were obligated to accept every bid they received, they obviously would never ask for bids at all! The law allows them to solicit and get as many bids as they want, because the bids are just offers, which they can accept or reject. This is crucial to commercial activity, especially with respect to big or expensive projects.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b contains further discussion of unilateral contract offers, such as reward offers.

2.4 The Offeror Can Terminate the Offer

As explained briefly in Section 2.2 above, before a proper acceptance, an offer can generally terminate in a number of ways. It can end because of the offeror, the offeree, or some other event or circumstance outside the direct control of the parties.

Section 2.4a discusses how offers can end where the offeror terminates the offer by revoking it. In common law jurisdictions, this can generally occur any time before a proper acceptance. However, such revocations may not be possible in many civil law jurisdictions. Many of these jurisdictions appear to say that offers cannot be revoked for a reasonable time unless the offer itself

says otherwise. In addition, even in common law jurisdictions, revocation may not possible in situations involving:

(1) option contracts (Section 2.4b);

(2) special statutes such as those governing offers for the sale of goods or bids submitted to public agencies (Section 2.4c);

(3) part performance in response to certain unilateral contract offers (Section 2.4d); or

(4) promissory estoppel (Section 2.4e).

These ideas are discussed below.

2.4a The Offeror Can Revoke Her Offer

In common law jurisdictions, the offeror can generally revoke her offer before the offeree has made a proper acceptance.

*** **DEFINITION:** A **revocation** is the act of withdrawing an offer.

This ability to revoke can be viewed as part of the offeror's general status as "master of her offer." Common law jurisdictions generally want the offeror to have the power to change her mind prior to acceptance. In a way, this could be viewed as part of the "freedom of contract"--the freedom to change one's mind and not make a contract. However, because this general rule does not always achieve justice or efficiency, there are several exceptions. These are discussed below.

It appears that many civil law jurisdictions say that an offeror generally cannot revoke her offer for a reasonable time, unless the offer itself says otherwise. This seems to be the case in Germany and France. This rule offers more protection to offerees. And it might reduce the need for some of the exceptions discussed later in this Section.

*** ***CASE STUDY 43*** **(Common Law)**

FACTS Somaly is a customer of the Friendly Drinks Shop. On Monday, he mails a letter to the shop ordering 20 cases of beer to use for a big party Saturday night.

However, on Wednesday, Somaly changes his mind about the order, and he goes to tell the Friendly shop owner. The shop owner has just received the order in the mail. Somaly tells him, "Never mind. I do not want the beer anyway. Just throw my letter way."

QUESTION OF LAW Did Somaly successfully revoke his offer to buy the beer?

DECISION Yes, in common law jurisdictions. Offerors like Somaly can generally revoke their offers any time before a proper acceptance, so this offer ended when Somaly revoked it before the shop owner accepted.

In common law jurisdictions, offerors can generally revoke any time before acceptance. In this case, the offeror Somaly sent an offer to buy some beer to a drinks shop, but then told the shop owner to throw the offer away just after the shop owner had received the offer. This was a revocation which ended the offer. So it does not matter if the shop owner tries to accept Somaly's offer now. No offer (anymore) = no contract.

(1) The Offeror Can Generally Revoke by Communicating the Revocation to the Offeree Before Acceptance

In general, in common law jurisdictions, an offeror can revoke by communicating the revocation to the offeree before acceptance. The revocation is effective on receipt by the offeree. Of course, if the offeree makes a proper acceptance before the revocation is effective, a contract is formed.

This general rule about how an effective revocation occurs can actually be divided into four key elements:

(1) the offeror can revoke only before acceptance;

(2) the revocation must be communicated;

(3) the communication must be to the offeree; and

(4) the revocation is effective only when received by the offeree.

These four elements are discussed below.

First Element: Revocation Can Occur Only Before Acceptance -- For a revocation to be effective, it must occur before the offeree makes a proper acceptance. After a proper acceptance, a contract is formed.

Common law jurisdictions usually--though not always--allow an offeror to revoke her offer at any time before the offeree accepts it, even if the offeror has stated that she will keep the offer open for a certain period! The idea is that if an offeror is generally the master of her offer, then she should generally have the right to withdraw the offer when she wants.

******* ***CASE STUDY 44*** **(Common Law)**

FACTS Kolab says to Srey Toch: "I have only $500. I offer to lend it to you if you promise to pay me back in 3 months at the rate of 10% interest per year. You do not have to decide now, because I will leave this offer open for you for at least one more week from today."

However, only three days later, before Srey Toch makes any acceptance, Kolab makes an agreement to lend the $500 to Sathya instead! Kolab immediately tells Srey Toch that she is revoking, and Srey Toch is angry. She realizes that the 10% interest rate is better than she can find anywhere else. Srey Toch thinks that Kolab has the obligation to keep her offer open to Srey Toch until the end of the week, as Kolab promised. Srey Toch also thinks that if she now tells Kolab that she accepts, then they have a valid contract.

QUESTION OF LAW Did Kolab have the right to revoke her offer to Srey Toch even though she had promised to keep that offer open a full week more?

DECISION Yes, in common law jurisdictions. Kolab's revocation was effective--even though she promised to keep the offer open a week--because it occurred before any acceptance by Srey Toch.

Except in certain special circumstances, many common law jurisdictions say an offeror may revoke her offer any time before the offeree has accepted that offer--even if the offeror promised to keep the offer open longer. In this case, Kolab communicated a revocation of her loan offer directly to Srey Toch before Srey Toch made any acceptance. This ended the offer. And it does not matter that Kolab had promised to keep the offer open longer. Common law jurisdictions generally allow a revocation even in that situation, as long as it occurs before the offeree accepts.

Of course, if the offeree properly accepts the offer before the offeror revokes it, then there is a contract between them. In that situation, it does not matter if the offeror really wanted to revoke, or if she had good reasons to revoke, or even if she had already started to revoke! That is, if the offeree's acceptance is effective first, there is a contract. But if the offeror's revocation is effective first, then there is no contract. So in some cases, it can be a kind of "race" to see which was effective first: the revocation or the acceptance.

******* ***CASE STUDY 45*** **(Common Law)**

FACTS One of the people who rented cars in front of the Hotel Indochine was named Meas. On Thursday, Meas offered to rent his new car to two of the hotel's honored guests, Harry and Matthew, so they could go to the beach at Kompong Som that weekend. Harry and Matthew thanked Meas for the offer. They told him that they would tell him the next day if they wanted to rent his car.

That night, Harry and Matthew went to the hotel restaurant to talk about their plans for the trip. They agreed that they would rent the car from Meas. Suddenly, they saw Meas enter the restaurant, so they waved him over to their table. But just as Matthew was about to tell Meas that he and Harry accepted the offer, Meas said to him, "Sorry, sir. I have already rented my car to another guest. You will have to find another car to rent if you want to drive to Kompong Som this weekend."

QUESTION OF LAW Did Meas have the right to revoke his offer in this way?

DECISION Yes. Meas' revocation was effective because it occurred before Matthew and Harry accepted his offer.

In common law jurisdictions, an offeror can generally revoke her offer any time before the offeree accepts it, even if the offeree wants to accept and is about to do so. In this case, Meas offered to rent his car to Matthew and Harry for a trip to Kompong Som. But he revoked that offer before they accepted. Even though Harry and Matthew had decided to accept the offer--and even though they were about to accept--they had not yet actually told Meas that they accepted his offer. Meas revoked the offer first. So in fact there was nothing left for these offerees to accept! In the "race" between the revocation and the acceptance, the revocation won.

Second Element: The Revocation Must Be Communicated -- For a revocation to be effective and terminate an offer, the offeror must communicate it. So if an offeror has not communicated a revocation, her offer remains open whether she wants it to be open or not. An offeror's intention or plan to revoke is not enough. As in many other areas of contract law, secret intentions have no legal effect.

*** ***CASE STUDY 46***

FACTS Pich, the manager of the Holiday Travel Agency, offers a special package to the student organization at the School of Commerce. Specifically, Pich offers to take the 80 students of the graduating class on his agency's boat up to Angkor Wat for five days and four nights during the Khmer New Year break, for only $50 per person. Pich agrees to let the leaders of the student organization talk to the other students that week to see if they want to accept his offer or not. But two days later, without telling the student organization or revoking his offer, Pich offers the same package to a new marketing association in the city, for $80 per person. The marketing association accepts immediately.

Pich writes a short letter of revocation and tells his assistant to give it to the student organization. But the assistant forgets. One day later, the leader of the student organization tells Pich that the students accept his offer. Pich is surprised, because he thought he had revoked his offer. The student leader is surprised to hear of the attempted revocation, because no one had told him about it. And Pich's assistant is very surprised, because the students say that, as a result of his failure to communicate Pich's revocation to them, there is a contract between Pich's travel agency and their group!

QUESTION OF LAW Is there a contract between the Holiday Travel Agency and the student organization?

DECISION Yes. There is a contract between the travel agency and the student group because the travel agency failed to communicate its attempted revocation, so the revocation was never effective.

Revocations must be communicated in order to be effective and terminate an offer. In this case, Holiday Travel made an offer to take a group of students to Angkor Wat. Pich tried to revoke that offer before the students accepted. Unfortunately for him, he never effectively revoked. Although Pich had decided to revoke the offer, and had even written a letter to do that, he failed to communicate the revocation, because his assistant forgot. In this case, the revocation went no further than Pich's assistant. So the students still had the power to accept Pich's offer. When they did accept the offer, they created a contract with Pich's travel agency.

Third Element: The Revocation Must Be Communicated to the Offeree -- For a revocation to be effective and terminate an offer, the offeror must not only communicate it, but communicate it to the offeree (or her agent). It is not enough for the offeror to simply communicate the offer generally; it must be to the offeree. This is because the offeree should have the opportunity to know that the offer that she is considering has been terminated. Otherwise, the offer remains open, and the offeree can accept it and form a contract.

*** ***CASE STUDY 47***

FACTS Suppose that the story in Case Study 46 happened in a somewhat different way. Suppose that Pich's assistant does not forget about Pich's revocation.

But the assistant does forget which students are the offerees. Instead of giving Pich's revocation to the students at the School of Commerce, Pich's assistant delivers the revocation only to some students at the School of Communications. The students who receive the letter there do not know what to do with it. Before they can do anything, the students at the School of Commerce accept Pich's offer.

QUESTION OF LAW Is Pich's revocation of his travel offer effective in this situation?

DECISION No. The revocation of Pich's travel offer is still not effective because he has failed to communicate it to the offerees--the students at the School of Commerce.

A revocation must be communicated to the offeree in order to be effective and end an offer. In this case, Pich's assistant did communicate the revocation of the travel offer. Unfortunately, the assistant failed to communicate the revocation to the offerees: the School of Commerce students. Those students never received the revocation. Then they accepted Pich's offer.

So as in Case Study 46, the School of Commerce students created a contract with Pich's travel agency.

Fourth Element: The Revocation Is Not Effective until the Offeree Receives It -- A revocation is effective only when the offeree (or her agent) receives it. This element is really related to the third element explained above. Many jurisdictions say that a revocation is adequately communicated to the offeree at the time the offeree receives it. It does not matter when the offeror actually sends or communicates the revocation, or even how the offeror does that.

Sometimes it may be hard to say exactly when an offeree "receives" a revocation. When an offeror revokes face-to-face or by phone with the offeree, obviously the offeree "receives" that revocation immediately, and the revocation is effective at that time.

But when the offeror sends her revocation by methods that are generally not immediate, such as regular mail, electronic mail, fax, or messenger, the revocation generally becomes effective only when it is delivered to the address of the offeree or the offeree's agent. So revocations communicated in those "non-immediate" ways are generally not effective when they are written, and not effective even when they are sent!

*** ***CASE STUDY 48***

FACTS On Monday, while Phirun was talking on the telephone with his favorite cousin Soubert, he offered to sell his rice mill to Soubert. Phirun said he would let Soubert think about the offer for a while.

However, on Saturday morning, Phirun changed his mind. He wrote a letter telling Soubert that he revoked his offer to sell the rice mill. Coincidentally, just after Phirun gave his letter for Soubert to the clerk at the post office, the clerk gave Phirun a letter addressed to him which the post office had just received from Soubert. In the letter, Soubert accepted Phirun's offer to sell the rice mill!

QUESTION OF LAW Did Phirun effectively revoke his offer in time to prevent Soubert from creating a contract by accepting the offer?

DECISION No. Phirun's attempted revocation was too late, because Soubert had already made a proper acceptance before he received the attempted revocation.

A revocation sent by "non-immediate" methods such as regular mail, fax, e-mail, or messenger terminates an offer only when that revocation actually arrives at the address of the offeree. In this case, Phirun wrote and even sent his revocation before he received Soubert's acceptance. But Phirun's revocation obviously did not arrive at Soubert's address before Soubert made

his acceptance, since Phirun got the acceptance before his revocation had even left his post office! So Phirun had not yet effectively revoked his offer when Soubert's acceptance arrived, and the offer was still alive. Soubert accepted that offer and formed a contract. Now Phirun must sell his rice mill to Soubert or provide a remedy.

This rule only requires that such revocations arrive at the address of the offeree (or agent) in order to be effective. That means they are effective at the moment that the revocation is delivered to the offeree's address. This rule does not require the offeree (or agent) to actually receive the revocation in her own hands, or even personally see or know about the revocation.

*** ***CASE STUDY 49***

FACTS The director of the Career English Company offered a teaching job to Kirany, whose English language ability was good. Kirany replied that she would consider the offer.

But one week later, the director hired someone else for the teaching position. So the director sent a messenger to Kirany's house with a letter in which the director revoked the job offer to Kirany. The messenger arrived at Kirany's house at 10:00 a.m., and when he saw that Kirany was not there, he left the letter in her mailbox.

At that time, Kirany was at work. She had decided to accept the director's offer, and she had already written her acceptance. So after finishing lunch, at 1:00 p.m. that same day, she went over to the Career English Company to personally deliver her acceptance to the director. But the director told her that the position was no longer open.

QUESTION OF LAW Did the director revoke his offer in time to prevent Kirany from creating a contract by accepting that offer?

DECISION Yes. The director's revocation was effective at the time it arrived at Kirany's house, so the offer ended before Kirany tried to accept it later that day.

Non-immediate revocations such as those sent by messenger are generally effective at the time they arrive at the address of the offeree. In this case, the director of the Career English Company tried to revoke his offer of a teaching job by sending a message to Kirany's house. This revocation was effective at 10:00 a.m., when the messenger delivered it to Kirany's house. This was three hours before Kirany tried to accept the offer. So the offer had been effectively revoked before Kirany tried to accept it. It does not matter that Kirany had already decided to accept the offer, or that she had actually written an acceptance. And it does not matter that Kirany did not even know that the director had revoked his offer! As soon as that revocation arrived at Kirany's house, the offer ended. No offer (anymore) = no contract.

*** ***WHY IS THIS IMPORTANT?*** What is the effect of the rule that a non-immediate revocation like one sent by mail or messenger is effective when it arrives at the offeree's address, even if the offeree does not personally receive or know about it?

This "effective on receipt" rule for revocations means an offeror only has to deliver her revocation to the offeree's address in order to terminate the offer. The offeror need not personally communicate the revocation, or even make sure that the offeree really knows about the revocation. This rule tries to be reasonable about what it requires offerors to do in order to revoke their offers. It would be a great burden on offerors if they had to make sure the offeree actually knew about a revocation, and it might be very hard to prove they did--much harder than proving the revocation had arrived at the offeree's address. This rule might seem harsh in some cases, such as where a different person at the offeree's address loses the revocation and the offeree never sees it. But the rule is based on the idea that people are generally responsible for receiving and reading communications that are delivered to their addresses. The law assumes this happens, and wants to encourage it to happen.

The rule also allows courts to work more efficiently. When parties ask a court to resolve a dispute related to revocation of an offer, the court need only determine if the revocation arrived at the offeree's address or not. The court does not have to try to determine if the offeree actually got the revocation, or saw it, or understood it. Obviously, that could be quite difficult in many cases, especially if the offeree denied it.

(2) The Manner of Revocation Can Be Direct or Indirect

As the above Case Studies suggest, there are generally no special procedures that an offeror must use when she wants to revoke her offer. The fact that the revocation is communicated to the offeree before acceptance is more important than the manner.

In fact, a revocation can occur in two ways:

(1) directly, where the offeror or her agent communicates it; or

(2) indirectly, which occurs where the offeree learns in some other way that the offer is no longer open.

These two ways are briefly discussed below.

Direct Revocations -- Offers can be revoked directly by a communication from the offeror (or her agent) to the offeree (or her agent). This is probably the most common way, and obviously the best way the offeror can be sure revocation occurs.

An offeror can directly revoke her offer through words (oral or written) or conduct that clearly shows that she is terminating the offer.

For example the offeror may say or write to the offeree, "I revoke my offer." Or the offeror may just tear up the piece of paper on which she wrote the offer. These are effective revocations. Case Studies 43-45 and 49 are examples of direct revocations. A direct revocation may also be made by an authorized agent of the offeror, as was attempted in Case Studies 46 and 47.

Indirect Revocations -- Offers can also be revoked indirectly where the offeree learns in some other way that the offer is no longer open because of the actions of the offeror. This means it is not necessary for the offeror herself to communicate a revocation to the offeree. For example, if an offeree learns from a reliable third party that the offer is no longer open, then the offer is revoked. An indirect revocation can also occur where the offeree simply observes that the offer is no longer open.

*** ***CASE STUDY 50***

FACTS On 1 July, Mealy wrote a letter to the City Textile Corporation in which he offered to lease the company a building for five years for $2,000 a month. Although Mealy knew that City Textile was very interested in the building and the terms of his offer, Mealy said he would allow City Textile 30 days to accept or reject the offer.

However, ten days later, Mealy leased the same building to the Elegant Fashion Company! Elegant Fashion immediately put up a big sign in front of the building which said, "New Headquarters of the Elegant Fashion Company--Grand Opening 21 July."

When the President of City Textile saw the sign, he was angry, and determined not to lose the chance to rent the building cheaply. He called a meeting of City Textile's Board of Directors. The Board voted to accept the lease and authorized the corporation's Executive Vice President to sign the offer from Mealy. Mealy insists that he had revoked his offer to City Textile.

QUESTION OF LAW Was Mealy's offer to City Textile revoked before City Textile tried to accept?

DECISION Yes. Although Mealy did not directly revoke the offer to City Textile, the offer was indirectly revoked when the President of City Textile saw the "Elegant Fashions" sign in front of the building.

Offers can be revoked indirectly--even where the offeror has communicated no revocation--where the offeree learns in some other way that the offer is no longer open because of some conduct of the offeror. In this case, the President of City Textile saw Elegant Fashions' "Grand Opening" sign on the same building that Mealy had previously offered to rent to City Textile. This sign clearly showed City Textile that Mealy's offer was no longer open, since Mealy had obviously rented the building to a different company. So this offer was revoked, and City Textile could no longer accept it.

*** ***WHY IS THIS IMPORTANT?*** Why can revocations occur indirectly?

Revocations can occur indirectly because in some cases that is more practical for the offeror. This rule is especially important in transactions involving the sale of land (as in Case Study 50), or some other kind of unique asset, such as a rare car or art. In such cases, offerors often offer the one piece of land or other asset to many offerees. Many jurisdictions generally assume that if the offeror actually makes a contract with one of those offerees, and other offerees find out about it indirectly (as City Textile did), those other offerees realize that the offeror can no longer perform her original offer to them. They understand that the offeror no longer intends her offer to be open. Offerees cannot make contracts by accepting offers which they know from a reliable third party or their own observation that the offeror has revoked.

Of course, if an offeree never learns about such a revocation indirectly, and the offeror also fails to revoke directly, the offer is probably still open, at least for a reasonable time. So if a party like City Textile in Case Study 50 had not learned about Mealy's revocation from the Elegant Fashions sign or any other way, the offer would have still been open. So City Textile could have accepted the offer, and Mealy would have been required to lease City Textile the building or provide a remedy.

(3) Public Offers Can Be Revoked in the Same Way They Were Made

Where a party makes an offer to the general public, such as a reward offer, that party can effectively revoke in the same way she made the offer. Such a revocation is effective even with respect to someone who saw only the offer, and not the revocation. So unlike the usual rule on revocation--which requires communication of a revocation to each offeree--this special rule allows a general public revocation for general public offers. Consider the following Case Study.

*** ***CASE STUDY 51***

FACTS In an attempt to try to find the famous wild Koprey of Cambodia, a biologist named Suviddya puts an advertisement in six newspapers offering a $1,000 reward for evidence which clearly proves the animal's present existence, and a $25,000 reward for a captured Koprey. In less than a week, however, Suviddya receives so much information and so many claims for the $1,000 reward that he decides to revoke his offer before he goes crazy and bankrupt. So he puts another advertisement in the same six newspapers thanking everyone for responding so enthusiastically to his request for information, but revoking his $1,000 reward offer.

Unfortunately, a man named Nate had seen the first advertisement but did not see the second one. So Nate continues to look for evidence of the Koprey. After about a month, he finally finds some bones which an expert

tells him are in fact the bones of a Koprey that died some time in the prior six months. Nate is very excited, especially because he is sure that Suviddya will pay him the $1,000 reward offered in the advertisement. But when Nate presents the bones to Suviddya, Suviddya refuses to pay him the $1,000, saying the offer has been revoked.

QUESTION OF LAW Did Suviddya effectively revoke his reward offer to all offerees when he put the revocation in the same newspapers in which the offer appeared?

DECISION Yes. Suviddya's revocation of his reward offer was effective because he revoked in the same way he made the offer, and this effectively revokes public offers.

An offeror can effectively revoke a public offer by revoking in the same way she made the original offer. Such a revocation is effective even against someone who saw only the offer, and not the revocation.

In this case, Suviddya revoked his offer of a reward for anyone giving him evidence of the Koprey's existence in the same way he made the offer: by advertisements in the same six newspapers in which he had made the offer. This was an effective revocation, even against parties like Nate who did not actually see it. So Suviddya's offer was revoked before Nate tried to accept, and Suviddya has no contract obligation to pay $1,000 to Nate.

*** ***WHY IS THIS IMPORTANT?*** Why can parties revoke public offers in the same way they made them, even though some offerees may not see the revocation?

Many jurisdictions allow this kind of public revocation of public offers because they want public offerors to have the right to revoke their offers. The law recognizes that in situations involving public offers--especially offers advertised in the media--it could be difficult or impossible for the offeror to actually communicate her revocation to every person who read the original offer. In order to give offerors a practical alternative, the law allows a manner of revocation that matches the manner of the offer. This protects the offeror, while giving offerees at least a reasonable chance of seeing the revocation. Otherwise, people might be deterred from making public offers at all.

2.4b An Option Contract May Prevent an Offeror from Revoking

As noted above, there are some situations where an offeror cannot revoke her offer, despite the general common law rule that offerors can revoke any time before acceptance. This text will examine four of these special situations, in Sections 2.4b-2.4e.

One of the most important of these situations is where the parties have an option contract.

*** **DEFINITION:** An **option contract** is a contract whose purpose is to keep an offer open.

An option contract is generally created when an offeree gives the offeror some money (or something else of value) in exchange for the offeror's promise to keep her offer open for a specific period of time. So the offeree actually buys the offeror's promise to keep her offer open for a limited period. The option contract is a separate contract, enforceable like any other contract. The only difference is that the purpose of the option contract is to hold open an offer for a different potential contract. Of course, as with any offer, the offeree is free to accept or reject the offer the option holds open. But by making the option contract, the offeree actually buys the right to accept that offer at any time during the option's stated period. And on the other side of the option, the offeror receives money (or some other valuable thing) in exchange for giving up her right to revoke during that period.

*** ***CASE STUDY 52***

FACTS Udom offered to sell Sambath his house for $60,000. In response, Sambath told Udom that he was very interested, but he would need about a month to collect the money. Although Udom was not so sure that Sambath would be able to raise so much money, he promised that if Sambath gave him $100, he would keep his offer open exclusively for Sambath for 30 days. Sambath, who really wanted to buy the house, immediately gave Udom $100. In return, Udom promised in writing to hold the offer open for 30 days.

But ten days later, Sambath heard that Udom had decided to sell the house to another buyer, without waiting for Sambath. Udom said his offer to Sambath was revoked. But Sambath told Udom he still had the right to accept the offer.

QUESTION OF LAW Does Udom have the right to revoke his offer to Sambath?

DECISION No. Udom made an option contract whose purpose was to keep the offer open for Sambath for 30 days, so Udom cannot revoke until the end of that period.

Option contracts hold offers open and prevent offerors from revoking them for the period stated in the option. In this case, Udom and Sambath had created a valid option contract whose purpose was to keep Udom's house sale offer open, only for Sambath, for 30 days. When Sambath bought that option, he purchased the exclusive right to decide any time during that 30 days whether to accept Udom's house sale offer. Udom gave up for 30 days the right he normally would have had to revoke his offer, in exchange for $100 from Sambath. So in this case, Udom cannot revoke his offer to Sambath for the 30 days stated in the option contract.

Although an option contract always relates to some offer, the option contract itself is a contract, separate from that other potential contract. In fact, that other potential contract may or may not ever be formed! This does not affect the option contract. And since an option contract is a contract, it cannot be "revoked" like an offer normally can.

For example, in Case Study 52, Udom could not revoke (for 30 days) his offer to let only Sambath buy his house, because the option he sold to Sambath did not allow it. Nor could he revoke the option contract, because binding contracts cannot be "revoked."

*** ***WHY IS THIS IMPORTANT?*** Why are option contracts important?

Options are popular and important in modern commercial activity. They are useful to both offerors and offerees. They have several key functions.

First, as illustrated in Case Study 52, option contracts give the offeree time to really think about the offer and whether she wants to (or can) create a contract with the offeror based on that offer. This is common in transactions where the offeree needs to raise money--often borrow it--in order to make a big purchase. But options can also occur in commercial situations where the offeree is a partnership, corporation, or other organization which has strict rules that require group or management approval before the organization can make an important contract.

Second, options try to reduce or "hedge" risk by allowing the offeree to "lock in" the right to do something, such as buy or sell some specific goods at a specific price during a specific period of time. In Case Study 52, Sambath wanted the option in order to "lock in" for 30 days his right to buy Udom's house for $60,000. Clearly, the option reduced Sambath's risk that Udom would sell his house to someone else, because the option prohibited that. It also reduced Sambath's risk that Udom would raise the price of the house, because the option locked in the $60,000 price. In many large contracts--such as those involving the sale of goods, huge amounts of money, or future sales or payments--the parties try to protect themselves against future changes in prices, or even money exchange rates, by creating options that lock in specific prices or rates for a stated period.

Finally, options earn money for the party who sells the option. This is sometimes easy profit for the option seller, because that party might have kept the offer open for some time without receiving any money for it! Of course, the option seller is giving up a right for a certain period, and sometimes that right can be valuable.

2.4c Special Statutes May Prevent an Offeror from Revoking Certain Types of Offers, Such as Offers for the Sale of Goods or Bids Submitted to Public Agencies

Another situation in which an offeror may be unable to revoke is where a special statute says the offeror cannot revoke for a certain time. These kinds of legislative limits on the revocability of offers really create another kind of option contract. And they have the same basic goal as options: to give the offeree time to think about whether to accept the offer or not.

One important example is where the offeror has made an "irrevocable" or "firm" offer to buy or sell goods. Commercial laws in some jurisdictions (such as the Uniform Commercial Code in the United States) basically say that if a merchant signs her written promise to keep open an offer for the sale of goods, that merchant may not revoke the offer until it expires. This is especially true when the merchant signs an offer which uses words such as "firm offer," "irrevocable," or "will be held open". Such offers will generally expire either at the time the offer specifies, or after a reasonable time if the offer does not state an expiration time. There may be upper limits on how long these periods can be, such as the three month limit under the Uniform Commercial Code.

Another important type of offer that statutes may prevent an offeror from revoking is a bid submitted to a public agency for the supply of goods or services. This kind of bidding process was already explained in Section 2.3d, and it will be further discussed in Section 2.4e below, which explains how promissory estoppel can also keep an offer open in the bidding process.

2.4d Part Performance in Response to a Unilateral Contract Offer May Prevent an Offeror from Revoking

Part performance in response to an offer for a unilateral contract will generally prevent the offeror from revoking for a reasonable time, in many common law jurisdictions. A few jurisdictions may still allow the offeror to revoke in this situation, but even in those jurisdictions the offeree could probably recover restitution of the benefit she provided to the offeror under the doctrine of quasi-contract.

In common law jurisdictions, a unilateral contract is basically an exchange of a promise for an act. This was already explained in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b. Unilateral contracts are created only when the offeree actually performs the specific act the offeror requested in her offer. So there is no contract until the offeree finishes that specific act. This is because there is no acceptance of the offer until the offeree finishes the act which the offeror asked for in her offer. Common law jurisdictions also generally say that an offeror generally may revoke her offer at any time before the offeree accepts. But in cases involving offers to create unilateral contracts, this general rule could create big problems--

and real injustice--if the offeror revoked her offer after the offeree started performing the act but before the offeree finished.

Because of this problem, common law jurisdictions generally say that part performance in response to a unilateral contract offer prevents the offeror from revoking for a reasonable time--basically creating an option contract. In this way, such jurisdictions allow the part performance of the offeree to make the offeror's offer irrevocable for a reasonable time. However, the only obligation that the offeror has during that time is the obligation to keep her offer open for a reasonable time. The offeror has no obligation to perform her side of the contract until the offeree has fully completed the requested act. And of course, the offeree has no duty to perform that act, since she has made no promise to do so. Consider the following Case Studies.

*** ***CASE STUDY 53***

FACTS Cambox Sports Events, Inc. put an advertisement in the major newspapers, on radio, and on television in which Cambox offered a $1,000 prize to the winner of the "Rainy Season Boxing Tournament" that it was organizing at the Olympic Stadium. According to the advertisement, there would be boxing matches every Monday and Thursday for six weeks, and the final championship match would be on the last Sunday of that period.

In response to the advertisement, many people joined the tournament and boxed. And there were many spectators, which meant Cambox was making a lot of money. As a result of all the boxing, the two boxers remaining at the end of the 6th week were Sok Rith and Ek Virek. But on the Saturday before the championship fight, Cambox canceled the final match and announced that the tournament was over. Cambox did not give any reason for the cancellation. And Cambox refused to pay Sok Rith and Ek Virek.

The lawyers for Cambox said that Cambox had no obligation to Rith and Virek, because Cambox had revoked its offer before they could accept it. The lawyers said that the offer Cambox had made was a unilateral contract offer which could only have been accepted by full performance--that is, by the two boxers actually fighting the final match. The lawyers said: "No completed performance = no acceptance = no contract = no obligation for Cambox = no money for Rith and Virek."

QUESTION OF LAW Could Cambox revoke its offer to Sok Rith and Ek Virek in this situation?

DECISION Probably not. In many common law jurisdictions, Cambox could not revoke its offer here because the boxers had partly performed in response to Cambox's offer of the $1,000 prize--a unilateral contract offer.

Even though an offeror can generally revoke her offer any time before the offeree accepts, part performance by the offeree in response to

unilateral contract offers can prevent the offeror from revoking. In many jurisdictions, where there is part performance, the offeror cannot revoke such offers for a reasonable time, in order to give the offeree a reasonable opportunity to finish doing what she had started in response to the offer.

In this case, Cambox offered a $1,000 prize to the boxer who fought all the way through its boxing tournament to be the champion. However, just before the final two fighters (Rith and Virek) were about to fight for the championship, Cambox tried to revoke its offer. This was after Rith and Virek had already boxed for six weeks in response to its prize offer--making Cambox a lot of money because of all the spectators and advertising revenue--and just before they would be able to finish their performance of the act Cambox had requested in its offer. In this situation, Cambox must keep its offer open for a reasonable time, and assuming Rith and Virek fight, pay the $1,000 prize to the winner, or otherwise provide a remedy.

*** ***CASE STUDY 54***

FACTS Prasith says to Someth, "I will give you $100 to plow my 50 hectares of land." Someth decides to accept Prasith's offer, and he starts plowing Prasith's land the next day.

But after Someth has plowed 20 hectares, Prasith tells him, "Sorry, Bong. I have run out of money because my wife is very sick, and she needs health care. So I have changed my mind about the plowing offer. I revoke my offer to you."

QUESTION OF LAW Can Prasith revoke his offer to Someth in this situation?

DECISION Probably not. In many common law jurisdictions, Prasith could not revoke his unilateral contract offer to Someth because Prasith had partly performed in response to the offer.

Even though an offeror can generally revoke her offer any time before the offeree accepts, many common law jurisdictions say part performance by the offeree in response to a unilateral contract offer can prevent the offeror from revoking for a reasonable time. In this case, Prasith's offer to Someth was an offer to create a unilateral contract, because it said that Prasith would pay Someth $100 if Someth performed the specific act of plowing Prasith's 50 hectares of land. The only way that Someth could accept Prasith's offer and create a contract with him was to plow all 50 hectares of Prasith's land. So there was no contract between Someth and Prasith at the time that Prasith told Someth that he revoked the offer.

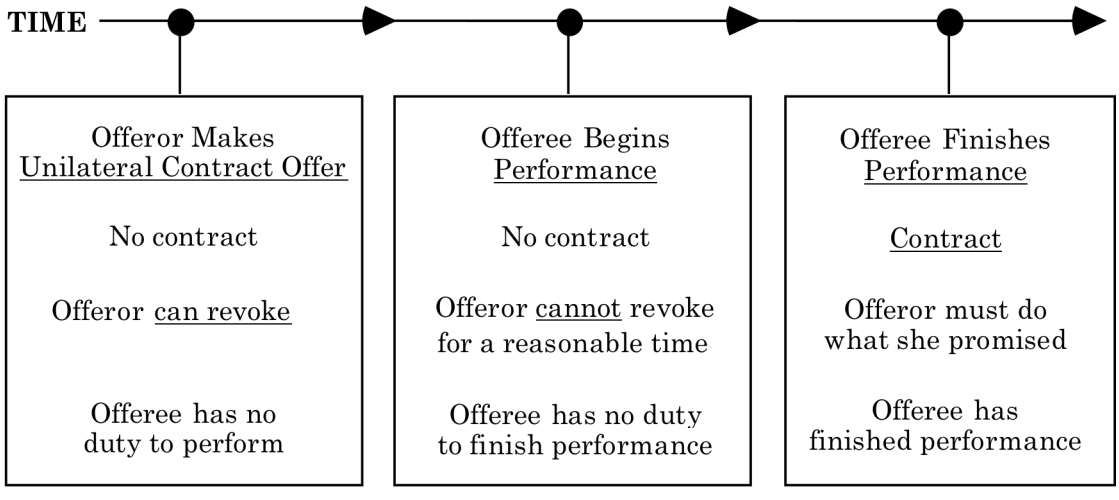
However, at that time, Someth had already plowed 20 hectares of Prasith's land. Because of the potential unfairness to Someth in this kind of situation, many jurisdictions say that Prasith cannot revoke his offer

for a reasonable time. Instead, he must give Someth a reasonable opportunity to finish the plowing.

Not all activity of offerees in response to unilateral contract offers is considered to be part performance that prevents an offeror from revoking. In fact, activity that is considered only preparation for performance will not generally stop the offeror from revoking. It appears that offeree activity in response to offers such as reward offers and client-broker offers often falls into this category. In these situations, the offerees often do many things--including spending substantial time and money--trying to accept the offer. For example, a reward offeree may spend time and money looking for a lost item.

However, it appears that such activities will generally not make the offer irrevocable, because they will not be considered part performance of the act requested. First, it may be that the act requested is really an act that can be done quickly, such as returning a car, or providing a buyer or seller for an item. Preparing to do such an act may not really be a part of the act. In addition, in these cases, the offeree does not generally provide any real benefit to the offeree unless she actually performs the whole act. And the offerees in these situations generally understand the risks that they take by trying to perform--the risks that they will not be compensated for their efforts. This is very different from the situation in cases like Case Studies 53 and 54, where the offerees clearly gave a benefit to the offerors, and had reason to expect that they would be given a reasonable opportunity to finish the act requested.

Illustration: How Part Performance May Prevent Revocation



A few common law jurisdictions may still permit an offeror to revoke her offer in this situation, under the general rule that offerors can revoke any time before a proper acceptance. However, even if a jurisdiction did allow that, the offeree could probably still recover restitution of the reasonable value of what she had provided to the offeror, under the doctrine of quasi-contract.

Otherwise, it would be unjust to offerees who provided a benefit to the offeror with a reasonable expectation that they would be allowed to finish their performance.

For example, if a court allowed Cambox to revoke in Case Study 53, it would probably still allow the boxers to recover the reasonable value of the benefit they had given to Cambox. And Someth could recover the reasonable value of the plowing he had already finished for Prasith. Otherwise, there would be unjust enrichment of the offerors.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b contains further discussion of unilateral contract offers, and Section 1.5 contains further discussion of quasi-contracts.

2.4e Promissory Estoppel May Prevent an Offeror from Revoking

Promissory estoppel may also prevent an offeror from revoking an offer in common law jurisdictions.

*** **DEFINITION: Promissory estoppel (detrimental reliance)** is a doctrine courts in common law jurisdictions use to avoid injustice by enforcing promises on which parties justifiably rely, even though there is no valid contract.

As explained in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4f, promissory estoppel (or detrimental reliance) is a doctrine which some common law jurisdictions use to avoid injustice where one party justifiably relies on the promise of another party, even though there is no valid contract. Courts may use it when one (or more) of the elements of valid contracts is missing--such as where the parties have not met the requirements of offer and acceptance, consideration, or formality--but for extraordinary reasons, the only way to avoid injustice is to enforce a promise one party made. The power of courts to use promissory estoppel is very limited. It appears that civil law jurisdictions do not use promissory estoppel, but they may have other ways to protect parties in these situations. Promissory estoppel is discussed in much more detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

One of the important situations where courts may use promissory estoppel is where an offeree justifiably relies on an offer--actually on a promise or promises in an offer--even though no contract has been formed yet. In these situations, a court may say that the offer cannot be revoked for a reasonable time, if that is necessary to achieve justice. Courts may actually say that there is a kind of "implied promise not to revoke" in these situations, even if the offeror does not expressly promise to hold the offer open.

However, in order for a court to use promissory estoppel to prevent an offeror from revoking an offer, the following five elements of promissory estoppel must be present:

(1) there must be a real case;

(2) there must be a promise by one party;

(3) another party must actually rely on that promise;

(4) that party's reliance must be justified;

AND (5) the party who relied on the promise will suffer an unjust loss or damage if the promise is not enforced.

Because it is very difficult to meet all five of these requirements, the power of the courts to use promissory estoppel is very limited. Courts cannot use promissory estoppel to enforce every promise that is made outside of a valid contract! The reason is that the law wants parties to meet all the requirements of valid contracts if they want promises to be enforced. Another important limit on promissory estoppel is that, when courts do enforce promises on this basis, they enforce them only to the extent that justice requires. This means that a party using promissory estoppel to enforce a promise will probably not be able to access the full range of legal remedies that are normally available with valid contracts. This issues will be discussed in more detail in Chapter 7.

One situation where promissory estoppel may be used to prevent an offeror from revoking her offer is in the important process of commercial bidding. Consider the following Case Study.

******* ***CASE STUDY 55***

FACTS The government asked an Investor Group to build a huge new Royal Theater. In order to prepare its bid to become the general contractor in charge of the construction of the Theater, the Prosperity Construction Corp. invited many sub-contractors to submit bids to do different parts of the work, under the supervision of Prosperity Construction. One sub-contractor, the Central Electric Company, submitted to Prosperity a bid to do all of the electrical work for the new theater for $50,000. Central's bid was the lowest that Prosperity received, and Central's reputation was generally good. So Prosperity used Central's $50,000 figure to calculate its own bid, which it submitted to the Investor Group.

The Investor Group chose Prosperity's bid, which made Prosperity the general contractor for the entire construction project. But before Prosperity could tell Central, Central informed Prosperity that it could not (and would not) do its part of the job, because of the rising costs of electric wire and labor! In fact, Central said it revoked its offer to Prosperity.

Prosperity immediately checked with other electric firms, and found that $70,000 was the lowest price that any of them would charge Prosperity to do that work. Prosperity signed a contract for that amount with one of the other firms, and then claimed $20,000 from Central. However, Central refuses to negotiate with Prosperity directly, and also rejects Prosperity's efforts to have an arbitrator help them solve their dispute. Now Prosperity asks the court to make a decision.

QUESTION OF LAW In this situation, could Central revoke its bid (offer) to Prosperity to do all the electric work for $50,000?

DECISION No. Central cannot revoke its bid (offer) to Prosperity in this situation under the doctrine of promissory estoppel because Prosperity justifiably relied on the bid in making its larger bid to the Investor Group, and injustice would result if Central was allowed to revoke.

Although common law jurisdictions generally let an offeror revoke any time before acceptance, offerors cannot revoke where the doctrine of promissory estoppel applies. Promissory estoppel applies where there is a real case, a promise by one party, reliance by another party, justifiable reliance by that party, and injustice will result if the promise is not enforced.

In this case, Central made a $50,000 bid to do the electrical work on the new Royal Theater for which Prosperity was bidding to be the general contractor. Central's bid was basically an offer. Prosperity became the general contractor using Central's bid, but then Central tried to revoke. Prosperity acted reasonably to find another sub-contractor, but that sub-contractor charged $70,000 for the work.

In this situation, all the elements of promissory estoppel seem to be present. First, Prosperity has brought the case to court, so the court can make a decision. Second, Central made a promise to Prosperity: Its $50,000 bid was actually a promise to do the electrical work on the project if Prosperity won the contract from the Investor Group. Third, Prosperity relied on Central's bid when it used Central's $50,000 figure to calculate its own bid. Fourth, even though they had no contract together, Prosperity's reliance on Central's promise (bid) was reasonable and foreseeable. Central knew that Prosperity might choose to rely upon its bid. And Central wanted Prosperity to choose and rely on its $50,000 bid--that was why Central submitted it to Prosperity. Fifth, if the court does nothing or lets Central revoke, Prosperity will probably lose at least $20,000 as a result of its reliance on Central's bid.

So in this case, under promissory estoppel, Prosperity's reliance will keep Central's offer to Prosperity open for a reasonable time. During that time, Central cannot revoke its offer (bid). And Prosperity can decide whether to accept the bid, which will automatically create a contract with Central, or to reject it. If Prosperity chooses to accept the offer (bid) and create a contract with Central, Central must either do all the electric work for $50,000,

or provide a remedy for any damage which Prosperity suffers as a result of Central's failure to do the work (here, at least $20,000).

Case Study 55 above is a good example of how common law jurisdictions may use promissory estoppel to protect the rights of general contractors (like Prosperity) who need to rely on bids from sub-contractors (like Central) in order to make their own bids. Specifically, promissory estoppel may say that sub-contractors like Central do not have the right to revoke their offers to general contractors like Prosperity which they might otherwise have, where general contractors have justifiably relied on the bids. In this way, the doctrine of promissory estoppel protects the important process of commercial bidding.

Of course, as explained in Section 2.4c above, special statutes may also protect public agencies from this kind of situation in some jurisdictions. These statutes often limit the rights to revoke of those who submit bids to such agencies.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4f contains a concise discussion of promissory estoppel; Chapter 3 (“Consideration”), Section 3.8g discusses how promissory estoppel might be used to enforce promises even where there is no consideration; and Chapter 7 ("Other Contract Formation Problems"), Section 7.8 contains a detailed discussion of promissory estoppel.

2.5 The Offeree Can Terminate the Offer

An offer can also be ended by the offeree. This Section explains how that can happen. In particular, it discusses:

(1) how the offeree can terminate the offer by rejecting it (Section 2.5a);

(2) how the offeree can terminate the offer by making a counter-offer (Section 2.5b); and

(3) potential offeree responses to the offer that are neither rejections nor counter-offers (Section 2.5c).

2.5a The Offeree Terminates the Offer If She Rejects It

The most obvious way an offeree can end an offer is to reject it.

*** **DEFINITION:** A **rejection** is a refusal to accept an offer.

A rejection is basically a negative response which shows the offeree will not accept or further consider the offer. A rejection terminates the offer. So after an offeree rejects, the offer can no longer be accepted to form a contract. Rejections end offers even if the period which the offeror agreed to keep

the offer open has not yet expired. Of course, after an offeree has rejected the offer, its offeror may decide to renew the offer. But if the offeror does not renew her offer, there is no longer any offer for the offeree to accept!

In order to be effective, a rejection must be communicated to the offeror. But an offeree need not use the word "reject" to reject an offer. An offeree can communicate her rejection to the offeror:

(1) by words (oral or written), such as when an offeree tells the offeror "no thank you" in response to an offer; or

(2) by conduct which clearly shows that the offeree has decided not to accept that offer, such as when the offeree tears up the offer in front of the offeror, or sends it back to the offeror unsigned.

*** ***CASE STUDY 56***

FACTS Chhom offered to sell ten rubies to Vanna for $2,000, and said: "Special for you, only $2,000. Final offer! No further negotiation!" Vanna really wanted the rubies, and she thought that she could bargain with Chhom even though he had said "final offer." So Vanna responded, "Oh Chhom! Your stones are much too expensive for me! There is no way that I can accept and pay you $2,000 for them! Sorry!"

Vanna then waited for a reaction from Chhom. But she was surprised when he said, "Well, that's unlucky for you!" and walked away. Vanna ran after him, saying, "No, no, forget what I just said. I will accept your offer at $2,000."

QUESTION OF LAW Did Vanna's attempted acceptance create a contract with Chhom which now requires him to sell the rubies to her for $2,000?

DECISION No. Vanna could not accept Chhom's offer because she had already terminated the offer by rejecting it.

A contract is created when the offeree properly accepts a valid offer. But if the offeree rejects the offer, she terminates that offer. So after that, there is nothing for the offeree to accept!

In this case, Vanna tried to accept Chhom's offer to sell her some rubies. Unfortunately, she had already rejected the offer when she tried to do that. This is because she said that there was "no way" she could accept and pay the price Chhom asked. This terminated Chhom's offer. So after that, there was nothing left for Vanna to accept. No offer (anymore) = no contract.

As discussed above in Section 2.4a, words or conduct are also the two principal ways in which an offeror can revoke her offer. In fact, rejections by offerees are similar in many ways to revocations by offerors. The following illustration shows some of the most important similarities between them.

Illustration: Comparison of the General Rules about Revocations and Rejections of Offers

QUESTION	REVOCATION	REJECTION
1. **Who makes it?**	The Offeror	The Offeree
2. **How is it made?**	By offeror's words or clear conduct	By offeree's words or clear conduct
3. **When is it generally possible?**	Any time before acceptance (common law)	Any time before acceptance
4. **When is it effective?**	When received by offeree	When received by offeror
5. **What is the result?**	Terminates the offer	Terminates the offer

As noted above, a rejection of an offer is generally not effective until the offeror receives the rejection. As with revocations, for non-immediate rejections this means the time when the rejection arrives at the offeror's address. So an offeree who sends a rejection to the offeror can change her mind if she makes a proper acceptance to the offeror before the rejection arrives.

In such cases, it can be a kind of race to see which happens first: the rejection or the acceptance. If the offeror receives the rejection before the offeree makes a proper acceptance, that rejection immediately terminates the offer--so there is no contract. But if the offeree makes a proper acceptance before the offeror receives the rejection, that acceptance immediately creates a contract, and the rejection has no effect. When an acceptance is effective--on dispatch by the offeree or on receipt by the offeror--may differ in different situations. That is discussed in more detail in Section 2.10e of this Chapter.

*** ***CASE STUDY 57***

FACTS Sinarau offered to install new electric wire between Van Than's house and the electric cabin of a private company in the city for $150. Van Than told Sinarau that he would think about it for a few days. The next morning Van Than decided not to accept Sinarau's offer. He wrote a short note to Sinarau thanking Sinarau for the offer, but explaining that he had decided against it. Van Than gave the note to one of the drivers for the company where he worked, and the driver promised Van Than that on his way home after work that afternoon he would personally deliver it to Sinarau.

However, at lunch, Van Than's friends convinced him that Sinarau's offer was actually cheap and reasonable. Van Than rushed back to the office, but he could not find the driver anywhere. So he called Sinarau on the telephone and said, "I have decided to accept your offer. Please disregard

any letter you might receive from me later today, and go ahead with your work to install the new electric line." Five minutes later, the driver arrived and gave Sinarau the rejection Van Than had written.

QUESTION OF LAW Did Van Than and Sinarau have a valid contract?

DECISION Yes. Van Than was able to accept Sinarau's offer because Sinarau had not yet received Van Than's rejection, so the offer was still open.

Rejections take effect--and terminate offers--only when they are received by the offeror, which for non-immediate rejections means when they arrive at the offeror's address. In this case, even though Van Than had decided to reject Sinarau's offer to install the electric wire--and even though Van Than had actually sent his rejection letter with the driver--Van Than had not yet terminated Sinarau's offer when he accepted. This is because Van Than made his acceptance to Sinarau before his driver delivered the rejection to Sinarau. If an offeree's proper acceptance precedes the arrival of the offeree's rejection, the result is a contract between the parties. That is what occurred in this case. So Van Than and Sinarau had a valid contract.

2.5b The Offeree Terminates the Offer If She Makes a Counter-Offer

An offeree can also terminate an offer where she makes a counter-offer.

*** **DEFINITION:** A **counter-offer** is an offer that the original offeree makes back to the original offeror, in response to the original offer.

As Section 2.5a explained, when an offeree responds negatively to an offer--rejecting it--that response terminates the offer. Often, such rejections also end the involvement of the parties with each other in that potential transaction.

But sometimes offerees say "no" only to certain aspects of the offer, in the hope that the offeror might agree to some change or changes. That is, the offeree may respond to an offer with interest, but with some different ideas about what she wants from the offeror. The offeree here is basically making a new offer back to the original offeror. This kind of response is a "counter-offer."

Sometimes counter-offers can actually look like acceptances. That might occur where the offeree appears to say "yes" to the original offer, but actually includes terms in her response that differ from those in the offer.

*** ***CASE STUDY 58***

FACTS Pokul offers to hire Chieng to be an accountant for a salary of $400 per month. Chieng says he agrees to work for Pokul for $500 per month.

QUESTION OF LAW What effect does Chieng's response have on Pokul's offer?

DECISION Chieng's response terminates Pokul's offer, because it is a counter-offer.

When offerees respond to offers with interest but include different terms in their response, that is generally a counter-offer which terminates the original offer. In this case, Chieng made a response to Pokul's offer of an accountant job that showed he was interested, but that differed in an important way from the offer. Specifically, Chieng indicated that he was interested in working as Pokul's accountant, but that he wanted more than the $400 salary that Pokul had offered him in the original offer. Chieng's response included a salary of $500 per month.

When Chieng responded to Pokul with a higher salary ($500), he did two things. First, Chieng terminated Pokul's offer of $400 per month. Second, he gave Pokul a new offer to consider. So Chieng himself became the new offeror! Now it is up to the new offeree (Pokul) to either accept or reject Chieng's counter-offer.

Obviously, counter-offers differ from acceptances. In Case Study 58, Chieng said that he "agreed" to work for $500 per month. But Pokul's offer had set the salary at only $400 per month. Chieng clearly does not "agree" to this lower salary. So his response is not an acceptance, but a counter–offer. It cannot be a proper acceptance because it requires Pokul's consent to different terms--it is not identical to the offer. This will be discussed in more detail in Section 2.10c of this Chapter, which explains that offeree response must generally be identical to offers in order to be proper acceptances.

In addition, while counter-offers are similar to rejections, they are also different. Specifically, counter-offers are similar to rejections because counter-offers terminate offers in the same way that outright rejections terminate offers. However, counter-offers differ from rejections because they are more than just a refusal of the offer. In fact, a counter–offer is actually a new offer, which the offeree makes back to the offeror! As a result, the original offeror can then decide if she wants to accept that counter-offer (and create a contract) or reject it.

The following chart compares acceptances, counter-offers, and rejections.

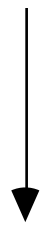
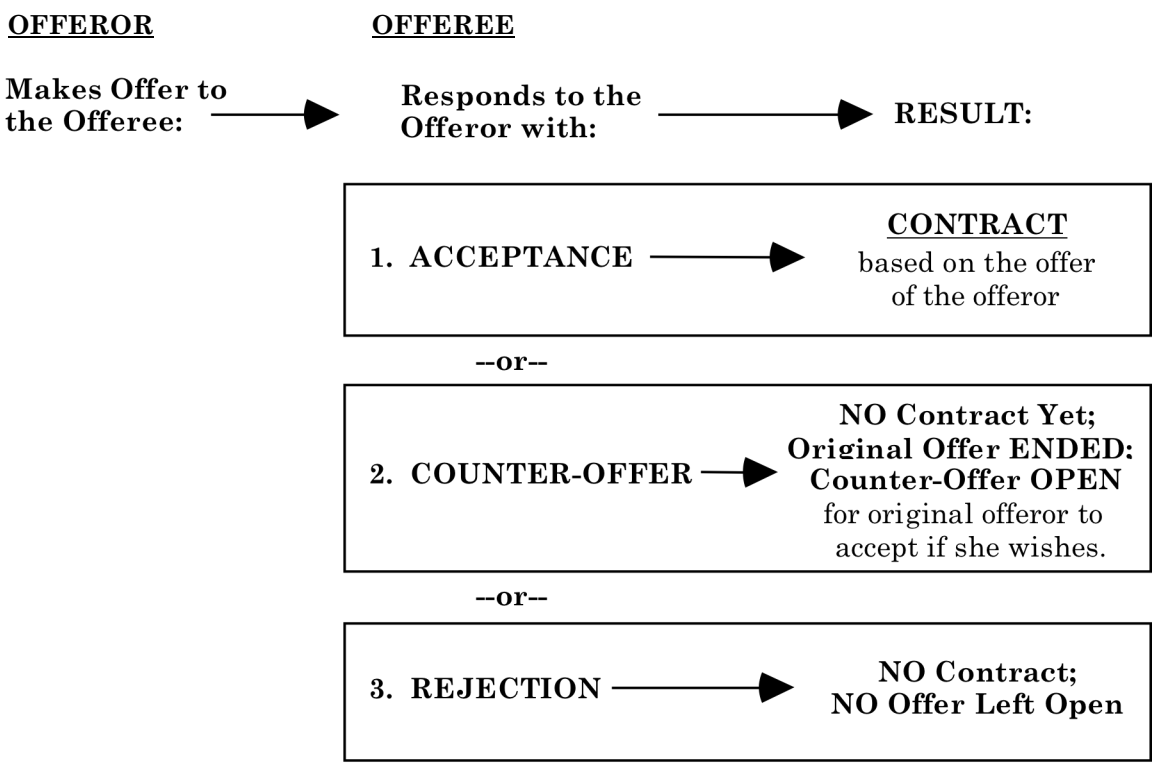


Illustration: Acceptance, Counter–Offer and Rejection



As illustrated above, when an offeree makes a counter-offer, she gives the original offeror the power to create a contract just by accepting the counter-offer! In such situations, the parties actually change roles:

- the original offeree becomes the new offeror;

AND

- the original offeror becomes the new offeree, gaining the power to either accept or reject the counter-offer.

*** ***CASE STUDY 59***

FACTS Lundi wanted to lend Mardi money that Mardi needed in order to buy some land. So Lundi wrote and delivered a letter to Mardi which said: "My offer to you is as follows: a loan of $2,000, at an annual interest rate of 12%, to be repaid in monthly installments of $150, with the first payment due one month from the date of our agreement."

Mardi was happy about the offer, but he wanted to pay a lower interest rate. He quickly wrote Lundi a note that said, "Thanks for your offer, Lundi! I accept all of your terms, but I will only pay you 10% interest." Lundi knew that the basic interest rate which most other lenders were receiving on similar loans was only 8.5%, so Lundi immediately wrote "Okay" on Mardi's note and signed his name, and delivered the note to Mardi.

Everyone was smiling until two days later, when Mardi realized that he would have to pay 1.5% more interest than most other borrowers. Mardi called Lundi back to demand the 8.5% rate for his loan, but Lundi refused. Lundi said they had already made a loan contract at 10%. But Mardi insists that he never accepted Lundi's offer of the loan, so Mardi has no obligation to Lundi.

QUESTION OF LAW Did Lundi and Mardi have a contract in this case?

DECISION Yes. Lundi and Mardi had a contract because Lundi accepted Mardi's counter-offer for the loan at 10% interest.

Counter-offers terminate the original offer, but leave open a new offer that the original offeror may choose to accept. In this case, Lundi made an offer for a loan contract to Mardi. Mardi is correct when he says that he did not accept that offer. In fact, although Mardi responded positively to the idea and most of the terms of Lundi's offer, Mardi expressed a different idea about a material term in the offer: the interest rate. Such a response is a counter-offer, which terminates the original offer.

But responses like Mardi's do more than just terminate the original offer: they are counter-offers that replace the original offer, in the opposite direction. Mardi's response is a counter-offer back to the original offeror Lundi, because it shows a present intent to make a loan contract at 10%. So now it is Lundi's turn to decide if he wants to accept the counter-offer or reject it. If Lundi accepts the counter-offer, he creates a contract with Mardi.

So when Lundi wrote "okay" on Mardi's note, signed it and delivered it to Mardi, he accepted Mardi's counter-offer with the 10% interest rate. This created a contract with Mardi based on that counter-offer. Mardi must respect that contract.

*** ***WHY IS THIS IMPORTANT?*** Why does it matter whether an offeree makes a rejection or a counter-offer in response to an offer?

Rejections and counter-offers by offerees both terminate the offer from the offeror. But rejections can have a much more final effect on negotiations than counter-offers. That is because a rejection by an offeree is a negative response that often terminates not only the offer itself, but also the communication between the parties about the offer!

By contrast, counter-offers are generally more positive responses by the offeree. They often lead to further negotiations between the parties--and even a contract.

In practice, when parties make counter-offers, they usually try to change offers in one or both of the following ways:

(1) the offeree may try to change some term or terms the offeror included in her offer; and/or

(2) the offeree may try to add new terms the offeror did not include in her offer.

In general, these kinds of changes cannot create a proper acceptance.

In fact, as discussed in Section 2.10c of this Chapter, free market jurisdictions generally require proper acceptances to be identical to--or "mirror images" of--the offer. That is, in order for the offeree to immediately make a contract with the offeror based on the original offer, the offeree's response to the offeror must (if it discusses contract terms) look exactly like the offer--like a reflection in the mirror! That means no changes and no new terms at all. This does not mean the contract terms must be stated in reverse order, or that numbers become reversed, as they would in a real mirror (for example, "$18" does not become "$81"). It means only that when an offeree responds to an offer with any different or new terms, there is no proper acceptance and no valid contract. The offeree generally must accept the offer as it is.

This "mirror image" rule generally applies to all kinds of contracts except sale of goods contracts in some jurisdictions. Commercial laws in many jurisdictions (including the Uniform Commercial Code in the United States) say that in situations involving the sale of goods, the acceptance does not have to be totally identical to the offer in order to be proper, as long as it is a definite expression of acceptance. The rules governing this situation can be complex. They are discussed in Section 2.10c of this Chapter.

*** ***WHY IS THIS IMPORTANT?*** Why is an offeree response that changes or adds to the offer generally a counter-offer which terminates the original offer, rather than a proper acceptance?

When the offeror makes an offer, her goal--and reasonable expectation--is to create a contract based on the offer she made. The offeror may generally change her ideas about the potential contract later, either because the offeror simply makes that decision, or because the offeree asks for the change. But it is generally up to the offeror alone to decide if, when, and how to make such a change. So an offeree cannot generally create a contract just by accepting an offer that the offeree changed without the offeror's consent! An offeree has the power to create a contract based on the offer the offeror made. But the offeree generally cannot create a contract based on anything else.

Counter-offers (like rejections) are generally effective only when the offeror receives them. So an offeror's offer terminates when the offeror receives a counter-offer from the offeree. It is sometimes possible under this "effective on receipt" rule for an offeree to create a contract by accepting

an offer after the offeree has already sent a counter-offer to the offeror. However, this can happen only in circumstances (such as in Case Study 57) where the offeree makes a proper acceptance of the offer before the offeror receives the counter-offer.

2.5c Potential Offeree Responses That Are neither Rejections nor Counter-Offers

Not every response by an offeree to an offer is a rejection or a counter-offer. In fact, many responses which offerees make are neither rejections nor counter-offers. Specifically, an offeree is not making a rejection or a counter-offer when she:

(1) just makes an inquiry about the offer, by asking a question about its terms, without indicating a rejection or counter-offer;

(2) properly accepts but complains about the offer, which may be called a "grumbling acceptance," but which still forms a contract because it still expresses agreement;

OR (3) simply accepts the offer.

So there are at least five different types of responses an offeree may make to an offer: a rejection, a counter-offer, an inquiry, a "grumbling acceptance," and an acceptance. Case Study 60 illustrates these five possibilities.



*** ***CASE STUDY 60***

PRELIMINARY FACTS The Khmae Boon Rung Company ("KBR") offers to pay the Painting Partnership $500 per unit to paint the 60 units in KBR's new office and residential complex, with $100 per unit in advance, the balance on completion, and the work to commence that week. When the Painting Partnership meets to discuss the offer, the partners consider the possibility of each of the following potential responses to KBR's offer:

FINAL FACTS-OPTIONS	QUESTION OF LAW	DECISION
Actual Partnership (Offeree) Response	**Type of Response**	**Result**
1. "No thank you, we are too busy right now."	= Rejection.	NO acceptance, NO contract, Offer from KBR terminated.
2. "Yes, but we want $250 per unit in advance."	= Counter-offer.	NO acceptance, NO contract, Original offer from KBR terminated and replaced by counter-offer from Partnership back to KBR.
3. "Sounds interesting, but can you raise the payment?"	= Inquiry.	NO acceptance, NO contract, but original offer (from KBR) NOT terminated.
4. "OK, we'll do it, but that's a lot less than we usually get."	= "Grumbling Acceptance."	CONTRACT.
5. "OK, we accept."	= Acceptance.	CONTRACT.

*** ***WHY IS THIS IMPORTANT?*** Why is it essential to distinguish among all the potential responses to an offer?

It is important to be able to tell the difference between all these potential responses because, as illustrated in Case Study 60, the different responses have such different effects. Offerees who make rejections or counter-offers no longer have any offer to consider, because they have terminated the offer made to them. However, when the offeree's response is neither a rejection nor a counter-offer, she does not terminate the offer, and so does not lose the power to create a contract just by accepting that offer. So when offerees just ask questions or make remarks, the offerees are not ending the offer. The offer stays open.

This is very important, because offerees often ask questions and make remarks when they consider offers. If each such question or remark had the same offer-killing, power-ending effect as a rejection or counter-offer, then there would be far less negotiation between parties--and perhaps

fewer contracts, and less efficient economic activity as well. Here again, contract law tries to accommodate how parties actually negotiate contracts.

2.6 A Specific Event or Circumstance Can Terminate the Offer

Even if neither the offeror nor the offeree terminates an offer, it is possible for some other specific event or circumstance to terminate it. This Section will discuss some of these events and circumstances.

In many jurisdictions, some important events which frequently terminate offers are:

(1) a lapse (passage) of a specified or reasonable amount of time after the offeror made the offer (Section 2.6a);

(2) the occurrence of a condition specified in the offer (Section 2.6b);

(3) the death or incompetence of a party to the contract or someone essential to the performance of the contract (Section 2.6c);

(4) destruction of the subject matter of the contract (Section 2.6d);

and (5) a change in the law that makes the offer illegal (Section 2.6e).

2.6a A Lapse Can Terminate the Offer

Sometimes offers end simply because of the passage of time, under the doctrine of "lapse."

*** **DEFINITION:** A **lapse** is a termination of some right or power because of a failure to exercise that right or power within some period of time, or because some particular thing fails to happen.

Time will eventually terminate an offer if it has not already been accepted or terminated in some other way. Specifically, an offer will lapse and terminate:

(1) according to the specific time stated in the offer or in any option contract related to that offer;

OR (2) if the offer or option does not state a specific time, after a reasonable time has passed since the offeror communicated the offer to the offeree.

These possibilities are discussed below.

(1) An Offer Terminates When It or a Related Option Contract Expressly Says It Will Expire

The offeror can control when her offer will lapse by specifying a time in the offer itself, or in a related option contract. For example, an offer may say, "This offer is good for a period of 10 days, beginning November 15." Or it may say, "You must accept this offer no later than December 1." In such cases, the offer terminates automatically at the end of the stated time. The offeror need not do anything else to terminate the offer. The offer expires by itself.

*** ***CASE STUDY 61***

FACTS Kanitha wanted to buy some land from the Delta Development Company. She sent a letter to Delta in which she offered $40,000 for the land. But Kanitha specified that Delta would have to accept within 15 days of the date on her letter.

On the 16th day after the date on the letter, Delta faxed Kanitha to tell her that it accepted her offer to buy the land. Kanitha replied that it was too late, and she refused to buy the land from Delta. Now Delta is asking the court to order Kanitha to pay what she had offered to pay for the land.

QUESTION OF LAW Did Delta and Kanitha have a contract here?

DECISION No. Delta and Kanitha did not have a contract, because Kanitha's offer to Delta had already lapsed before Delta tried to accept it.

Offers lapse and terminate at the time the offer itself specifies. In this case, Kanitha's offer to buy Delta's land had specifically stated that it was open for 15 days from the date on her letter. The words "within 15 days" mean 15 days maximum--not 16 days, and not even 15 and 1/2 days! So at the end of the 15 days, Kanitha's offer lapsed, and Delta's attempted acceptance by fax on the 16th day did not create a contract. No offer (anymore) = no acceptance = no contract.

Although many offers clearly state when they will expire--as in Case Study 61--some offers use more general terms. For example, many offers include phrases such as: "For immediate acceptance," or "Offer open for a limited time only." Unfortunately, such language often causes problems, not only for offerees who want to know when an offer will expire, but also for courts which may need to decide whether an offeree accepted an offer before it lapsed. If the parties are not clear about this, then the court may have to refer to the other rules about lapse discussed later in this Section. In that situation, general terms about when an offer lapses may be only one factor in a court's analysis of how much time is a "reasonable" time for the offer to remain open before it lapses.

In fact, such general terms can be a problem even when an offer seems clear about when it ends. For example, an offer which says "This offer good for 10 days" may seem clear about when it terminates. But it is really not so clear unless the offeror also specifies exactly when the "10 days" starts. It may start on a particular date which the offer itself specifies, on the date the offeror sends the offer, or on the date the offeree receives it. Courts usually assume that the time starts from when the offer is received by the offeree, but this is not always clear, especially if there is some delay in delivery of the offer.

So careful offerors should be as specific as possible when they state that their offers will end at a particular time. For example, in Case Study 61, Kanitha was careful to state that her offer was open for 15 days starting from the date on her letter.

(2) Where neither the Offer nor a Related Option States a Time for Expiration, the Offer Will Lapse After a Reasonable Time

If neither the offer nor a related option states a specific time when the offer will expire, and no other event ends the offer, then the offer will end a reasonable time after the offeror communicated the offer to the offeree. This rule may seem straightforward, but it is not always easy to say how much time is reasonable in a particular case.

In order to determine how much time is reasonable, courts look at the offer itself and the surrounding circumstances. In particular, many jurisdictions say the offer will terminate after a reasonable time based on:

(1) the subject matter of the offer,

AND (2) the circumstances surrounding the offer.

Of course, many civil law jurisdictions say not only that offers do not generally lapse for a reasonable time, but that offerors cannot generally revoke them for a reasonable time, unless the offer permits that.

Briefly, if the subject matter of an offer is some kind of perishable goods (such as fruit), or an item whose price can change quickly (such as currency), then unless the offeror indicates otherwise, the offer will usually have a very short life. This is because for such offers, it is reasonable to assume that the offeror made her offer only for a limited period. Offers involving other types of subject matters that are more durable or have more stable prices (such as land) will probably last longer.

The circumstances surrounding an offer are also considered. Relevant circumstances include: the wording of the offer; the manner in which it was made; the general market conditions at the time; other economic forces; and prior dealings between the parties.

Both of these factors are explained in more detail below.

(1) Subject Matter -- The subject matter of an offer can have an important effect on how long the offer lasts. Consider the following Case Study.

******* ***CASE STUDY 62***

FACTS One Monday morning, Suthirak, the manager of the electric company, received a fax from his oil supplier. The supplier offered him 1,000 barrels of oil at $48 per barrel, which was the current price in a very busy, rapidly changing market. Suthirak immediately sent a brief fax back to the supplier, saying that he would think about the offer.

On Tuesday, the price of oil rose to $52 per barrel. Late Tuesday afternoon, Suthirak sent the supplier a fax accepting the supplier's offer at $48 per barrel. The fax arrived at the supplier's office after the office had already closed for the day.

By the time the supplier saw Suthirak's acceptance fax on Wednesday morning, the price of oil had risen to $56 per barrel. The supplier called Suthirak to say that his acceptance had arrived after the offer had already expired. Suthirak argued that he had accepted the very next day after the offer was made. He claimed that his acceptance created a binding contract which required the supplier to provide the 1,000 barrels at $48 per barrel, as the supplier had offered to do. Now Suthirak is asking a court to order the supplier to either obey the contract or pay compensation to Suthirak.

QUESTION OF LAW Had the supplier's offer already expired before Suthirak accepted it?

DECISION Probably. The supplier's offer for the sale of oil had probably expired because offers for the sale of goods whose prices change so rapidly generally lapse very quickly.

If an offer itself does not indicate a specific time for expiration, and the offer does not end in any other way, that offer will expire after a reasonable time. In many jurisdictions, what is "reasonable" depends on both the subject matter and the circumstances of the offer.

In this case, the subject matter of the offer was oil, a type of goods whose price can rise and fall dramatically in a free market. Both parties here understood this. Ordinarily, offerors do not keep their offers for such goods open for a long time. In fact, such offers normally expire very soon if the offeree does not accept immediately. But it is not necessary for such an offeror to actually say that her offer will expire so quickly. So it does not matter that the oil supplier here did not say when his offer would expire. And of course,

Suthirak's fax to the supplier which said that he "would think about" the supplier's offer had no effect on the offer.

The circumstances of the case also indicate that the supplier's offer was to be open only for an very short time. First, the fact that the supplier chose to send a fax to Suthirak--a very fast way to communicate--suggests that the supplier wanted to make his offer and receive Suthirak's acceptance fast. Second, the price of the oil in fact did change between the time that the supplier made his offer to Suthirak (on Monday morning) and the time that Suthirak finally responded to the offer (after the close of business on Tuesday afternoon). As with the subject matter analysis above, it would be unreasonable to say that the supplier's offer stayed open that entire time.

So in this case, the offer had probably lapsed before Suthirak tried to accept it. If the supplier had wanted his offer to stay open for more than a very short time, he should have said so clearly. And if Suthirak had really wanted to create a contract at the original price, he should have accepted the offer much sooner--in fact, he should have accepted immediately. But these things did not happen. So the oil supplier's offer probably expired after a period of time that is reasonable for offers like this to expire--and that was long before Suthirak finally tried to accept. No offer = no acceptance = no contract.

Although this subject matter rule can be important in all kinds of contracts, it is very important in the trade and finance activities of businesses and governments. There are thousands of transactions every day, together worth billions of dollars, in which the value of the subject matter can rapidly change, and where the offeror normally does not indicate when her offer will expire. Such transactions include the sale of:

- stocks and bonds;
- commodities, such as oil; gold and other precious metals; rice, wheat, cotton, rubber and other agricultural products; and
- currencies (the exchange of the money of one country for the money of another country, such as riels for baht).

The above rule about how the subject matter affects the life of an offer protects and encourages offerors. That promotes the important trade and finance activities in which they are involved. Specifically, even if an offeror selling or buying such items did not specify when the offer would expire, she almost certainly did not intend the offer to be open forever! And if such an offer is not open forever, then who decides when it does expire? The offeror failed to say, and it would clearly be unjust to let the offeree decide when the offeror's offer would expire. So the law must decide when such offers expire. Of course, the law cannot anticipate every situation, so it simply says offers expire after a reasonable time. And it is reasonable for offers with subject matters like these to be open only a short time.

In addition, when an offeror makes an offer, she gives a great power to the offeree: the power to make a contract by properly accepting the offer. So when an offer relates to goods whose value rapidly changes, there can be great risk for the offeror while her offer is open. Specifically, in an offer to sell at a certain price (as in Case Study 62), the offeror risks a loss if the general market price goes up but the offeree is still able to accept the offer at the earlier lower price. In an offer to buy at a specific price, the offeror risks a loss if the general market price goes down but the offeree is still able to accept the offer at the earlier higher price. But there is normally no risk at all for the offeree, because she is free to accept the offer or not!

Of course, if the subject matter of an offer with no specific expiration time is more durable or has a more stable value, the reasonable time for the offer to be open will be longer. In fact, the length of time that is "reasonable" for an offer to remain open generally increases with the stability of its subject matter. For example, if an offeror of land or other interests in real property did not say when her offer would expire, a reasonable time for the offer to remain open would probably be at least several days, and possibly much more.

(2) Circumstances -- In order to determine what is a "reasonable time" for an offer to expire when the offer itself does not clearly say, it is also important to consider the circumstances surrounding the offer. This requires a close analysis of the facts in the case, because each case is different. Among the circumstances which often affect how much time is "reasonable" are:

(a) The words the offeror used when she made the offer. Even where an offer does not say specifically when it will expire, the offer may contain some indication of how much time it is open. For example, words like "First come, first served!" and "Offer ends soon!" obviously indicate a short life for the offer. This was already noted above, in the Section about what happens when an offer uses general terms to describe when it expires.

(b) The manner in which the offeror made the offer. For example, in Case Study 62, the supplier chose to make his offer by using one of the fastest ways available for him to communicate in writing to a distant person: a fax. Other offerors might use a telephone, or make their offers face-to-face. Sometimes (though not always) such a manner suggests that it is reasonable to expect that offer will be open only a short time.

(c) The general market or business conditions at the time the offeror made the offer. In Case Study 62, the market price for oil rose nearly 10% within a day after the supplier made his offer to Suthirak. Although such price changes may be normal for goods such as oil, similar circumstances might also occur with other types of goods whose value does not normally change so much.

For example, suppose there is a sudden shortage of clean water or candles, and the market price for such goods (which usually does not

change much) rises rapidly. In that situation, it is reasonable to expect offers for the sale of such items to be open only a short time, unless the offeror says otherwise.

(d) Other economic forces affecting the offer, such as supply and demand pressures and competition. Unless the offeror indicates otherwise, an offer for the sale of goods of which there is a low supply and for which there is a high demand (like a valuable painting or an ancient statue) will probably not last long. The same is true of offers relating to things for which there is a lot of competition, such as a good job or a desirable piece of land.

(e) Prior business dealings between the parties. As with many other areas of contract law, it is important to consider any transactions the parties have already had with each other. These might suggest how long an offer is open, even if the offer does not say specifically.

(3) Limits on the "Reasonable Time" Rule -- The "reasonable time" rule explained above has two major limits. The first limit is that the rule applies only in cases where the offer itself did not clearly specify its expiration time. For example, offers of goods whose value changes rapidly might specify a long period of time before expiration. And offers as to items with a stable value might specify only a short period before expiration. Courts enforce such statements. So if the offeror specifies an expiration time that turns out to be too long, and as a result the offeror ends up with a contract that is unfavorable to her, she will not be protected by the "reasonable time" rule.

The second limit is the element of "reasonableness." The rule says "reasonable" time; it does not say "best" or "ideal" time. The rule only protects the offeror from the offeree's attempt to accept the offer at a later time than is "reasonable." This gives a lot of protection to offerors. But it does not protect them from every risk, or prevent every acceptance or contract that an offeror no longer likes. It will not protect offerors from their own mistakes, or from a bad deal or bad luck. If the offeree properly accepts an offer within a reasonable time, then even though the goods' value or the offeror's plans may have changed during that period, the offeree creates a legally binding contract with the offeror. The offeror must obey that contract.

*** ***WHY IS THIS IMPORTANT?*** Why does the law impose these two limits on the "reasonable time" rule?

One of the most important principles in free market contract law is the freedom of contract. That means that the parties are generally free to make their contracts as they choose. But freedom carries both opportunities and risks! True freedom of contract means not only the freedom to make a contract that turns out to be profitable, but also the freedom to make a contract that may not turn out to be so profitable! Courts generally enforce contracts without regard to whether it was wise for a party to make them or not.

And each contract starts with an offer, so freedom of contract also includes the freedom to make offers that may turn out to be unwise.

In free market jurisdictions, the role of the law and the job of courts is not to rewrite offers. Nor is it to revise contracts so that every contract is good, fair or reasonable for every party. Of course, if courts did this, it might seem to achieve greater "fairness" in particular cases. But the idea of rules like these two limits is that if the courts rewrote contracts in that way, courts would in fact be interfering in contracts--and restricting or destroying the "freedom of contract" of the parties. Then parties could not rely on the contracts they made! This would increase risk and could discourage economic activity. Parties might even be afraid to make profitable contracts, for fear that the courts might rewrite them. Or they might not bother to make good contracts, since they could always ask the courts to do it for them. The courts themselves might be overwhelmed by parties trying to get their contracts rewritten in this way. The result might be a less productive economy.

So in order to promote freedom of contract, free market jurisdictions generally try only to make sure that the process for making and enforcing contracts is basically fair for all the parties. So if an offeror uses her freedom of contract to make an offer which includes a specific expiration date, the law will ordinarily respect that particular date--whether it seems reasonable or unreasonable. If an offeror does not clearly state an expiration date, only then will the law and the courts apply the "reasonable time" rule.

2.6b The Occurrence of a Condition Which the Offer Specified May Terminate the Offer

Sometimes offerors say that their offers terminate if a certain condition occurs.

*** **DEFINITION:** In contract law, a **condition** is a particular future event which is not certain to occur, but whose occurrence will affect the formation or performance of a contract.

In general, a condition can be summarized in two words: if-then. For example, if it rains, then rice can grow. As with other conditions, it may or may not rain. If it does rain--if the condition occurs--then rice can grow. But if it does not rain--if the condition does not occur--then rice cannot grow.



Illustration: How Conditions Work in General



This also means that:

If X does not happen, **then** Y will not happen. That is, the occurrence of Y actually depends on the occurrence of X.

In contract law, conditions are generally particular events whose occurrence will have some effect on the formation or performance of a contract. The role of conditions with regard to contract performance was discussed in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4h, and it will be discussed in detail in Chapter 9 ("Performance and Discharge of Duties"). But for now, this text will focus on the role of conditions in affecting the formation of contracts--and specifically in affecting whether an offer ends.

Sometimes offers say that they will terminate if a certain event occurs. In other words, if some event occurs, then the offer ends. The occurrence of such a condition will terminate an offer if:

(1) the offeror communicated the condition in the offer; and

(2) that condition occurs before the offeree properly accepts the offer.

The reason for this rule is that the offeror is generally the master of her offer, and the law generally wants her to be able to control when her own offer may be accepted. The following Case Study demonstrates the ability of such a condition to terminate an offer.

*** ***CASE STUDY 63***

FACTS Rathanak, an engineer who works full time for a big construction company in Phnom Penh, says to a shop owner in the city: "I offer to fix the roof on your shop for $900. My offer will terminate exactly three weeks from today. But if my boss tells me I have to leave Kandal Province to work on a job somewhere else before three weeks from today, the offer expires at the time my boss tells me."

The shop owner decides to accept the offer. But he does not say "OK" to Rathanak until 8 days later. When the shop owner tells Rathanak, Rathanak replies, "Sorry! My boss told me 3 days ago that I have to go up to Battambang to work on a project there." Now the shop owner asks the court to order Rathanak to either fix his roof for $900 or provide some other remedy.

QUESTION OF LAW Did the shop owner's attempted acceptance create a contract with Rathanak?

DECISION No. The shop owner could not create a contract because the condition specified in Rathanak's offer had already terminated the offer.

Conditions can terminate offers. In this case, Rathanak made an offer to fix the shop owner's roof. But his offer contained a condition. Specifically, Rathanak said his offer would stay open for three weeks unless Rathanak's boss told him before the end of three weeks that his job required him to leave the province. If that condition occurred, then the offer would expire at that time. So the shop owner had three weeks to accept Rathanak's offer unless Rathanak's boss told Rathanak that he had to leave before that time.

Unfortunately for the shop owner, Rathanak's boss did tell him, before three weeks had passed, that Rathanak had to go work in Battambang. And under Rathanak's offer, that event was a condition which automatically terminated Rathanak's offer. It did not matter whether the shop owner found out about the termination or not. No offer (anymore) = no contract.

Illustration: How a Condition Terminates an Offer

When an offer says that it will terminate if a specific condition occurs, the result is that:



The termination of the offer in such cases is automatic. The offeror need not do anything. She need not revoke the offer, or even tell the offeree about the termination. In fact, the offeree need not find out about the termination at all! And the occurrence of a condition will terminate the offer any time before the offeree has properly accepted the offer. So in Case Study 63, Rathanak's offer could have expired two days or even one minute after he made the offer, if that was when his boss told him that his job required him to leave the province. But if the shop owner had properly accepted the offer before Rathanak's boss told Rathanak, then a contract would have formed.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4h contains a concise discussion of how conditions affect contract performance; and Chapter 9 ("Performance and Discharge of Duties"), contains a detailed discussion of how conditions affect contract performance.

2.6c The Death or Adjudicated Incompetence of the Offeror, the Offeree, or Any Other Person Necessary to Perform the Proposed Contract Can Terminate the Offer

In many jurisdictions, if an offeree has not yet properly accepted an offer, the offer will terminate as to that offeree at the time that the offeror,

the offeree, or any other person essential to the performance of the contract dies or is declared incompetent by a court. Many jurisdictions say someone who is dead or judicially declared incompetent cannot make a real agreement about an offer. Of course, it might appear that the real problem, at least with an adjudicated incompetent person, would be a lack of capacity. And many courts view other persons essential to the performance of the contract in a similar way: their death or adjudicated incompetence generally means no real agreement can occur. It might appear that the real problem there would be mistake or impracticability, rather than a lack of real agreement. But in any event, many jurisdictions say there can be no real agreement in these situations, so the offer terminates.

Of course, where there are multiple offerees (as in public offers), and one offeree dies or is adjudicated incompetent, that event will not terminate the offer as to the other offerees, unless the affected offeree is essential to the proposed contract between the offeror and other offerees. For example, if an offeree named Kolab dies, the offer will immediately terminate as to Kolab, but not as to an offeree named Keary, unless Kolab was somehow essential to the proposed contract between the offeror and Keary.

It is also important to note that, as explained in Chapter 4 ("Capacity"), Section 4.5, a party who is incompetent but has not been declared incompetent by a court can generally make a voidable contract. So it would seem that this rule about the termination of offers would not generally apply to offers involving such persons, though some legal authority says the offer still terminates if the offeror becomes incompetent and the offeree knows about it. The reason for this general distinction between adjudicated and unadjudicated incompetent persons is that many jurisdictions say a judicially declared incompetent person no longer has any legal capacity to make a contract. In fact, the person's legal capacity is transferred to someone else: a guardian.

Where a person who is essential to a contract dies or is judicially declared incompetent after an offer is made but before acceptance, many jurisdictions say the offer terminates automatically. So as with offers that terminate when a specified condition occurs, no special act or communication is needed to terminate the offer. In fact, it is generally not even necessary for one party to know about the other party's death or incompetence!

At a minimum, in order for an offer to be properly accepted, many jurisdictions say the persons necessary to the proposed contract must be alive and not judicially declared incompetent at the moment the offeree accepts the offer. Otherwise, there is no offer to accept--because it terminated--and as a result, there is no contract.

***	***CASE STUDY 64***
FACTS	Boran offered in writing to sell 50,000 bricks to Huot for $10,000. But on the way home from work that afternoon, Boran died in a car accident.

A few days later, Huot, who was not aware of Boran's death, sent a letter addressed to Boran in which he accepted Boran's offer.

When Huot found out what had happened to Boran, he called Boran's house to express his condolences. But Huot also wanted to make sure that Boran's family had received his acceptance of Boran's offer and would respect the contract which Huot thought resulted. Boran's family thanked Huot for his concern about Boran, but politely refused to recognize any contract with Huot based on Boran's offer.

QUESTION OF LAW Did Boran's offer to Huot survive after Boran's death so that Huot could make a contract by accepting it?

DECISION No. Boran's offer terminated at the time Boran died, so Huot could no longer accept it.

Many jurisdictions say offers terminate when the offeror dies. In this case, the offeror Boran died before the offeree Huot tried to accepted Boran's offer for the sale of bricks. So there was no offer at the time Huot sent his acceptance to the factory. No offer (anymore) = no contract.

This rule generally terminates offers not only when a party to a potential contract dies or is judicially declared incompetent, but also when such events affect any other person who is essential to the performance of the proposed contract.

*** ***CASE STUDY 65***

FACTS Nath was the most famous painter in the country. Nath's brother wrote and mailed a letter to Damnang. In the letter, Nath's brother offered to sell Damnang a new, special painting by Nath of Angkor Wat for only $200, and to deliver the painting to Damnang as soon as Nath finished it.

Damnang received the letter two days later, and immediately wrote to Nath's brother to accept the offer. But as Damnang was driving to the post office to mail his acceptance to Nath's brother, Damnang saw a funeral procession coming towards him, on its way to the wat, carrying a big picture of....Nath, and the body of the dead Nath behind it!

Damnang realized that Nath's paintings would now become even more valuable than before. So he rushed up to Nath's brother, gave him the letter and said, "I am sorry about your brother, but I am happy about your offer. I accept!" Damnang knew that Nath could not possibly have finished the new painting for him. But he also knew that Nath had given his brother several good paintings of Angkor Wat before he died. Damnang insists that, because he properly accepted the offer from Nath's brother, he now has a right to receive one of the old paintings from Nath's brother, in order to satisfy the brother's obligation under the contract.

QUESTION OF LAW Did Damnang create a contract with Nath's brother when he accepted the brother's offer in this way?

DECISION No. The offer which Nath's brother made terminated when Nath died, so Damnang can no longer accept it.

Many jurisdictions say an offer automatically terminates if a person who is essential to the performance of the potential contract dies before the offer is accepted. In this case, Nath's brother offered to sell Damnang a painting to be painted by Nath. Nath was the key to the performance of this proposed contract. Obviously only Nath could paint the new "painting by Nath!" When Nath died before Damnang accepted, the offer died too. So there was no offer left for Damnang to accept. No offer (anymore) = no contract.

This rule applies only to offers which the offerees have not yet properly accepted, like all the other rules discussed in this Section on termination of offers. But if the offeree properly accepts an offer and a contract is formed, and later a party or person necessary to the performance of the contract dies or is adjudicated incompetent, then other rules apply. There the problem is what happens to an existing contract. In that case, conditions may be excused and contract duties may be discharged under doctrines such as impossibility and impracticability. Such situations are discussed more fully in later Chapters.

*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity"), Section 4.5 discusses the ability of incompetent persons to make contracts; Chapter 7 ("Other Contract Formation Problems"), Section 7.3 discusses when agreements may be invalid because of mistake; Chapter 9 ("Performance and Discharge of Duties"), Sections 9.4j and 9.8a discuss how impossibility and impracticability of performance can affect conditions and contract duties; and Chapter 10 ("Remedies") discusses potential remedies in such situations.

2.6d Destruction of the Particular Subject Matter of the Offer Can Terminate the Offer

Many jurisdictions say an offer terminates if its particular subject matter is destroyed before the offeree properly accepts the offer. Of course, as with the rules about the death or incompetence of persons needed to perform a proposed contract explained in Section 2.6c, it might seem that the real problem here would be mistake or impracticability, rather than a lack of real agreement.

In any case, this rule applies when the offer is about a specific, particular thing. An example would be an offer to sell a particular ship called the "Green Giant." This rule does not apply to an offer without such a specific subject matter, such as one for the sale of "five kilograms of rice."

*** ***CASE STUDY 66***

FACTS Sastra owned the most popular restaurant in Kompong Som. This restaurant had for many years had the biggest New Year's party in all of southern Cambodia.

A Cambodian-French investor named Sok LaBete made a written offer to buy Sastra's restaurant for a high price. The offer required Sastra to give LaBete a letter of acceptance in French in Phnom Penh if Sastra wanted to accept the offer. Sastra immediately said he would probably accept the offer, but that he would not be able to write his acceptance until the 18th of April, because he did not know much French and he would not be able to find a qualified Khmer-French translator in Kompong Som until after the holiday.

Unfortunately for Sastra, a lightning storm caused a big fire on the night of April 15th, and Sastra's restaurant burned to the ground. Although Sastra was at first dismayed, he soon realized that he could completely rebuild the restaurant and still make a profit by selling it to LaBete at the price LaBete had offered. So on April 18th, Sastra hired a translator and together they wrote an acceptance letter in French. On the 19th, Sastra hired a taxi, traveled to Phnom Penh, and personally gave the letter to LaBete. But LaBete replied, "*Quoi? Non!* We do not have a contract. Your restaurant is *fini*! It's too late, *Monsieur*."

Now Sastra asks the court to order LaBete either to pay him for the restaurant, or provide some other remedy.

QUESTION OF LAW Could Sastra accept LaBete's offer and make a contract that would obligate LaBete to buy the restaurant from Sastra?

DECISION No. LaBete's offer terminated when the restaurant was destroyed by fire, so Sastra could no longer accept it after that time.

In many jurisdictions, an offer ends at the time its particular subject matter is destroyed. In such cases, an offeree no longer has the power to make a contract with the offeror just by accepting her offer, because there is no longer an offer for that offeree to accept!

In this case, LaBete offered to buy Sastra's restaurant. The particular subject matter was Sastra's original restaurant--not just "a restaurant," or even a new or rebuilt restaurant. So while that restaurant existed, LaBete's offer to Sastra existed, and Sastra's power to make a contract with LaBete based on that offer also existed. But Sastra had not yet properly accepted LaBete's offer when its particular subject matter (the restaurant) was destroyed. In this case, lightning caused the destruction. LaBete's offer was destroyed at the same time. Of course, Sastra and LaBete are free to negotiate a new contract for the land or for a new restaurant.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.3 discusses when agreements may be invalid because of mistake; Chapter 9 ("Performance and Discharge of Duties"), Sections 9.4j and 9.8a discuss how impossibility and impracticability of performance can affect conditions and contract duties; and Chapter 10 ("Remedies") discusses potential remedies in such situations.

2.6e A Change in the Law That Makes an Offer Illegal Can Terminate the Offer

Even if an offer was legal at the time the offeror made it, many jurisdictions say the offer will generally terminate if the proposed contract becomes illegal before acceptance because of a change in the law. As with the events explained in Sections 2.6c and 2.6d, it might appear that the real formation problem here is something other than real agreement--in the case of a change in the law, it might seem to be legality.

In any case, this rule means that if the performance of the proposed contract becomes illegal after the offeror makes the offer but before the offeree properly accepts it, that offer is terminated. This occurs automatically. It does not require any act or awareness of the changed law by either party.

*** ***CASE STUDY 67***

FACTS On November 10, Nagalogs Inc., a private timber corporation, offered to sell to the Dee Mak Wood partners 50,000 logs which Nagalogs would cut and process in a certain nation during the first six months of the following year. But on November 30, before all the partners in Dee Mak had a chance to consider the offer, the National Assembly of that nation passed a new law. This law prohibited the export of newly cut logs beginning January 1. Nevertheless, one week after the law came into effect, Dee Mak delivered its acceptance letter to Nagalogs headquarters, with 20% of the total price of the transaction as a down payment.

QUESTION OF LAW Did Dee Mak create a contract with Nagalogs by accepting its offer?

DECISION No. Dee Mak could not properly accept Nagalogs offer because the offer had become illegal and terminated prior to the attempted acceptance.

Many jurisdictions say that offers generally terminate if they become illegal after they are made. In this case, although Nagalogs' offer to sell logs was legal on November 10 when it was made, the offer was no longer legal when Dee Mak delivered its acceptance letter to Nagalogs. In fact, Nagalogs' offer was legal only until the effective date of the law which made the object of Nagalogs' offer--the export of newly cut logs starting January 1--illegal. As soon as that happened, Nagalogs' offer terminated. So Dee Mak's ability

to accept and make a contract for the logs also terminated. No offer (anymore) = no contract.

This rule about offers that become illegal is similar to the basic contract law rules about illegal contracts. As explained briefly in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4d, courts generally refuse to enforce contracts that are illegal. Of course, the rule discussed above seems to incorporate the separate requirement of legality into the requirement of real agreement. But whether the legality of an offer is considered to be a "legality" problem or a "real agreement" problem, the result is the same: no valid contract can generally be formed.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4d briefly discussed the important formation requirement of legality; and Chapter 5 ("Legality") discusses legality more fully.

2.7 An Acceptance Is an Offeree's Indication of Agreement with an Offer

The other major element of real agreement is the acceptance.

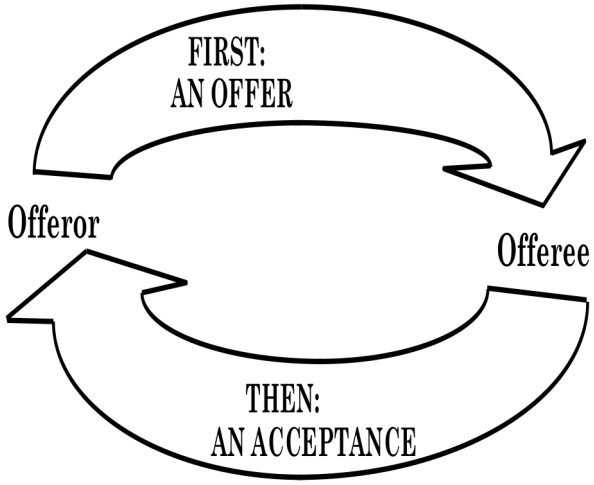
*** **DEFINITION:** An **acceptance** is an offeree's indication of agreement with an offer.

A proper acceptance by at least one party is an essential part of every contract. As noted earlier in this Chapter, a valid offer plus a proper acceptance creates real agreement. Of course, not all attempted acceptances are proper. Only a proper acceptance creates a contract. At the moment that an offeree properly accepts a valid offer, she creates a legally binding contract with the offeror, assuming other formation requirements are met. The rest of this Chapter discusses the basic requirements for a proper acceptance to occur.

At the outset, readers might wish to review the following illustration from Section 2.1 of this Chapter.



Illustration: How Offer and Acceptance Create Real Agreement



So while the potential for a contract exists when a valid offer is made, the actual contract occurs only when there is a proper acceptance of that offer. The following chart compares offers and acceptances.

Illustration: Valid Offer vs. Proper Acceptance

QUESTION	VALID OFFER	PROPER ACCEPTANCE
1. Who makes it?	The Offeror makes an offer to an offeree.	The Offeree makes an acceptance back to the offeror.
2. Who has power to decide the form and manner?	The Offeror decides how to make her offer.	The Offeror decides how she wants the offeree to make a proper acceptance.
3. What does it do?	Gives the offeree the power to create a contract by properly accepting.	Actually creates a binding contract with the offeror.

In general, acceptances can be made expressly (using words) or impliedly (using conduct). Potential ways to accept offers include:

(1) orally;

(2) by a document such as a letter;

(3) by telephone;

(4) through special documents designed for particular transactions;

(5) through conduct which clearly shows the offeror that the offeree has accepted the offer.

The first four possibilities above are examples of express acceptances, because the offeree is using words to make her acceptance. In fact, offerees who want to accept an offer usually respond directly to the offeror, either orally or in writing, using words such as "OK" or "I accept."

The fifth possibility on the list, however, is an implied acceptance. That can occur where the offeree's conduct (not words) demonstrates her acceptance to the offeror. In practice, parties sometimes indicate their acceptance of an offer through their actions. Some examples of this kind of acceptance follow.

(1) An affirmative act or gesture by the offeree can be an acceptance. This might occur when the offeree nods her head in a way that shows agreement, or when she accepts payment from the offeror.

(2) The offeree's performance of the particular act the offeror requested can be an acceptance. For example, when a customer requests a haircut and the barber cuts the customer's hair without saying anything, the barber's performance of the specific act the customer requested may be an acceptance of the customer's offer.

(3) The offeree's use of services the offeror offered can be an acceptance. For example, when someone parks a moto in a parking lot, the moto owner's use of the parking service--even without words--can show that she accepts an obligation to pay for the parking service.

(4) The offeree's possession or control of the offeror's property which the offeror offered can be an acceptance. For example, if an offeror who wants to sell a car lets a potential buyer (offeree) temporarily drive the car in order to decide whether to accept the offer, and the offeree keeps and drives the car a long time, the offeree's actions may indicate her acceptance of the offer.

However, there are limits on how an offeree can make a proper acceptance. Two major types of limits on how an offeree can accept are special requirements of the offeror and the law. The offeror or the law (or both) may say that if the offeree wants to make an enforceable contract based on an offer, then the offeree must make her acceptance in a specific way. In such cases, an offeree is not free to accept the offer in any way she wants!

The rest of this Chapter discusses the specific rules that govern how a proper acceptance can occur. In particular, many jurisdictions say that:

(1) only the intended offeree can generally make a proper acceptance (Section 2.8), except that:

   (a) a non-offeree can accept an offer made to her by mistake if she did not know and had no reason to know of the mistake (Section 2.8a); and

(b) multiple offerees can accept an offer even if the offeror really wanted a contract with fewer of them (Section 2.8b);

(2) unilateral contract offers can generally be accepted, in common law jurisdictions, by full performance of the requested act (Section 2.9);

(3) bilateral contract offers can generally be accepted by the making of the return promise requested, where that promise:

(a) is communicated to the offeror (Section 2.10a);

(b) is unequivocal and unconditional (Section 2.10b);

(c) is identical to--a "mirror image" of--the terms of the offer (Section 2.10c); and

(d) is made in a proper manner, including meeting any special requirements of the offeror (Section 2.10d); and

(4) where it is not clear whether an offer is for a bilateral or unilateral contract, it appears that most jurisdictions allow the offeree to accept either by performing the act or making the promise requested (Section 2.11).

Before readers review the ideas about acceptance presented in Sections 2.8-2.11, they might consider a few introductory thoughts about what may be the most basic part of the analysis of whether an acceptance is proper in common law jurisdictions. This is the analysis of whether the offer requests that the offeree perform an act or make a promise--whether it is an offer to form a unilateral contract or a bilateral contract.

*** ***WHY IS THIS IMPORTANT?*** Why must parties in common law jurisdictions consider whether an offer requested an act (a unilateral contract offer) or a promise (a bilateral contract offer)?

This distinction is important for several reasons. One is that the two types of offers obviously have different basic requirements for a proper acceptance. For unilateral contracts it is the performance of an act, whereas for bilateral contracts it is the making of a promise. Offerees must know what kind of offer they have received in order to accept properly. If it is not clear, most jurisdictions basically say the offeree can accept either way, as will be discussed in Section 2.11 below.

In addition, there are more rules about how to make proper acceptances of bilateral contracts. This may be partly because such contracts are often more complex, and partly because bilateral contracts are considered to be more common. Contracts for land and other things of great value, including commercial and international contracts, are usually bilateral. Bilateral contracts generally provide more protection for offerors in business, who are usually seeking a firm commitment that the offeree will perform.

This is because the bilateral offeror receives a promise that what she wants done will be done, whereas the unilateral offeror does not.

Of course, as explained in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b, many civil law jurisdictions use the terms "bilateral contract" and "unilateral contract" to mean different things. For example, in France, it appears that bilateral contracts are basically those with obligations on both sides, whereas unilateral contracts are basically those with obligations on only one side.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b discusses unilateral and bilateral contracts.

2.8 In General, Only the Intended Offeree Can Make a Proper Acceptance

In general, only the party the offeror chose--the "intended offeree"--can make a proper acceptance of an offer. So an attempted acceptance by anyone else generally does not form a contract. In fact, it is often a new offer to the original offeror.

If the offeror directs her offer to a group of parties, then any member or members of that group can generally accept the offer. The same principle applies if the offeror directs the offer to the public in general, as in most reward offers: any member of the public who knows about the offer can accept it.

If an offeree authorizes someone (an agent) to accept on her behalf, that person can form a contract--but only between the offeror and the offeree. The person accepting on the offeree's behalf is not a party to the contract.

This purpose of this general rule about intended offerees is to make sure that the offeror can direct her offer to whomever she wants, with confidence that generally only that party can accept the offer and create a contract. As with many other rules of contract law, such restrictions are based on the idea that an offeror is the generally the master of her offer.

*** ***CASE STUDY 68***

FACTS Souvann, a computer instructor, decided to sell his computer in order to buy a new one. Souvann's computer was old, but in excellent condition. Even though Souvann knew he could probably get $500 for the computer, he decided to offer it to his students for less. So he told his students in class that he would sell his computer for only $400 to the first student in the class who accepted the offer.

That afternoon, one of the other teachers, who was named Mareth, met Souvann outside the school. Mareth said, "I heard about your offer to the students today, and I accept." Souvann replied that he had offered the computer only to his students, but that he would sell it to Mareth if none of the students wanted to buy it. But Mareth insisted that his acceptance of Souvann's offer had already created a contract between them.

QUESTION OF LAW Did Mareth create a contract with Souvann by trying to accept Souvann's offer?

DECISION No. Mareth could not accept Souvann's offer because he was not an intended offeree--only the students in Souvann's class were.

In general, only the specific person to whom an offeror makes her offer--the intended offeree--can properly accept the offer. In this case, Souvann offered to sell his computer for $400 only to the students in his class. So only one of them could accept the offer. Mareth could not accept the offer or create a contract. No offer (to Mareth) = no proper acceptance (by Mareth) = no contract (with Mareth).

The decision in Case Study 68 above is similar to the decision in Case Study 37 in Section 2.3c of this Chapter. In Case Study 37, someone who was not the intended offeree tried (but failed) to accept an offer to buy a house. Such acceptances are generally not valid, because contract rules about offer and acceptance try to protect the offeror's right to decide to whom she will make an offer--and with whom she might have a contract.

*** ***WHY IS THIS IMPORTANT?*** Why do courts apply this general rule that only the intended offeree can accept an offer?

The power to accept an offer is the power to make a contract. This great power comes from the offeror, and the offeror must decide who she wants to receive the power. That is, contract offerors choose their offerees; offerees do not create themselves! This rule generally prevents offerees from creating themselves. If offerors could not generally decide who could accept their offers, then offerors could not control with whom they might have a contract. And there would be some contracts created by offerees with whom the offeror did not want to have a contract--even though the contract was based on an acceptance of her offer!

For example, a money lender might not want to make contracts with everyone--only those who she felt could repay the loan. Otherwise, there would be many problems of non-performance, and many conflicts which would not occur if the offeror had been able to control who could accept her offer. The rule avoids this result by giving the offeror that control.

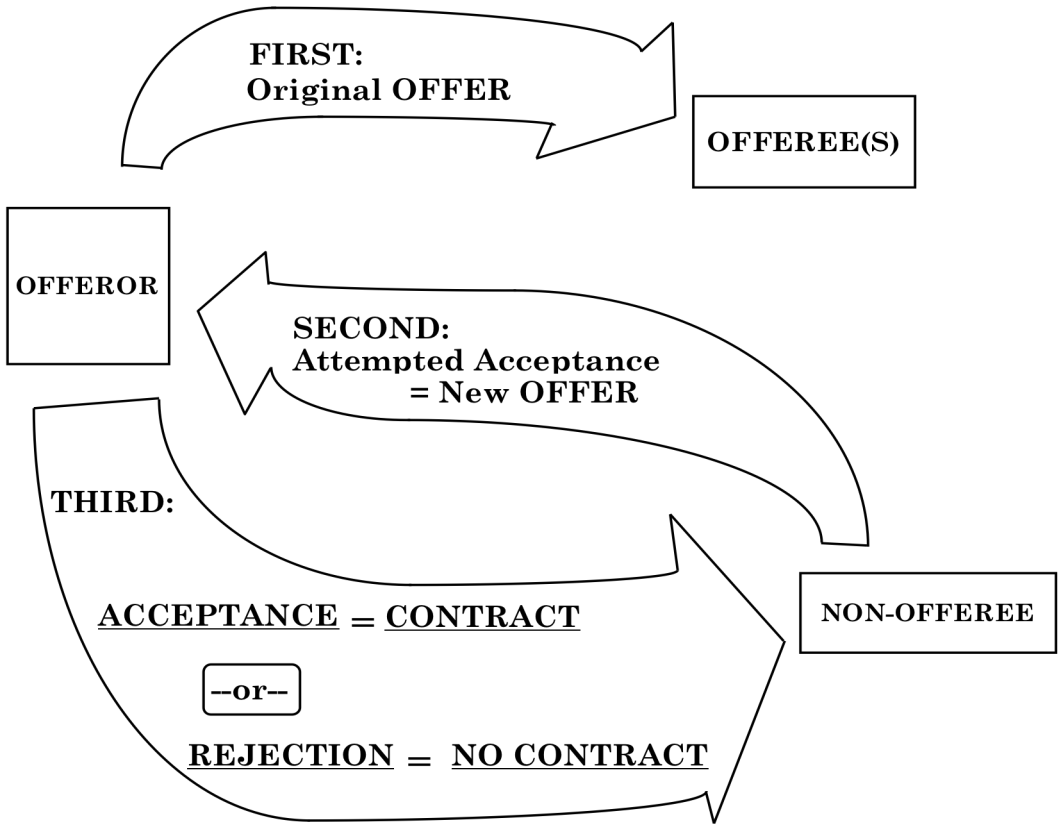
Although someone other than the intended offeree generally does not have the power to properly accept the offer, the attempted acceptance by

that other party is often a new offer back to the original offeror. So then the original offeror can either accept the new offer (and create a contract) or reject it.

For example, in Case Study 68 above, Mareth could not accept Souvann's offer, because Souvann had not made his offer to Mareth. But Mareth was free to make a new offer to Souvann for the computer--and Mareth probably did by making the attempted acceptance! If Souvann had wanted to accept Mareth's offer, they could have made a contract together. So the eventual result in many such situations is an enforceable contract.

Except for one difference, these rules are similar to those for counter-offers, which were discussed in Section 2.5b of this Chapter. The key difference is that, unlike with counter-offers, here the party responding to the offer is not the offeree to whom the offeror intended to make her offer. In fact, the party trying to accept here is a "non-offeree." So that party's attempted acceptance is just a new offer back to the offeror, and not a counter-offer.

Illustration: How an Acceptance Attempted by a "Non-Offeree" Can Be a New Offer, Which May Result in a Contract ("1" happens first, then "2" happens, then "3" happens)



However, offerors are not always protected by the general rule that lets them choose their own offerees. In fact, there are two situations in which the general rule does not prevent offerors from losing control of which parties have the power to accept their offers and make a contract with them. Specifically, those two situations occur when an offeror makes her offer:

(1) to a non-offeree by mistake, and the non-offeree accepts without knowing or having a reason to know of the mistake (Section 2.8a);

OR (2) to more than one offeree, and more offerees accept than the offeror thought would accept (Section 2.8b).

In both of these special situations, the offeror has made some mistake or error in judgement, and allowing her to avoid a potential contract might harm the reasonable expectations of others. So in these situations the law tries to balance its general protection of offerors with some protection for the reasonable expectations of other parties.

2.8a A Non-Offeree May Accept an Offer Made to Her by Mistake If She Did Not Know or Have a Reason to Know of the Mistake

Sometimes an offeror wants to make an offer to one particular party, but by mistake the offeror communicates the offer to a different party. This can be a big problem for the offeror. The reason is that many jurisdictions say that, even though it was just a mistake, the other party has the power to accept that offer if:

(1) the other party does not realize the offer was a mistake; AND

(2) a reasonable person in the other party's situation would not have realized it was a mistake.

This "reasonable person" standard is similar to the ones discussed earlier in this text. Consider the following Case Study.

*** ***CASE STUDY 69***

FACTS The Tith Textile Company obtained some rare imported silk. The Company wanted to sell this silk to its best customer, Ouk. In fact, Ouk was such a good customer that the Company decided to offer him a price that was lower than the market price for the silk.

By mistake, however, the Tith Textile salesperson mailed the offer to another one of the company's customers, Chhim. Chhim was surprised and pleased at the good offer. He immediately accepted the offer in writing. As soon as the sales manager at the Textile Co. saw the letter from Chhim, he called Chhim to tell him the offer was a mistake, so there was no contract.

Chhim replied that he was sorry, but if the Textile Co. did not give him the silk at the price on the offer, then he would be forced to sue the company in court.

QUESTION OF LAW Is it possible for Chhim to accept the Textile Company's offer even though Chhim was not the intended offeree?

DECISION Yes. Chhim could have made a proper acceptance of this offer--even though he was not the intended offeree--if he did not know or have a reason to know of the Textile Company's mistake in sending the offer to him.

Although generally only offerees chosen by the offeror can properly accept an offer, a non-offeree may properly accept the offer if she did not know and had no good reason to know that the offer was really intended for someone else. In this case, the Textile Company sent an offer to sell some rare silk to its customer Chhim, even though it intended to make the offer only to a different customer, Ouk. Chhim tried to accept. To see if his attempted acceptance was proper, a court would try to determine whether he knew or should have known of the mistake.

Assuming Chhim says he did not know about the mistake, a court would examine other evidence. If the offer was addressed to Chhim, or if there was no name on the offer, and there was no other evidence to show that Chhim should have known the offer to him was a mistake, then the court would probably say the acceptance was proper. It would then enforce the contract, and require Tith Textile to deliver the silk or provide another remedy to Chhim.

However, suppose only the envelope was mistakenly addressed or delivered to Chhim--but the letter making the offer was correctly addressed to Ouk. In that case, Chhim might have had a reason to know of the mistake. So a court might not find that there was a contract in that situation.

Sometimes an offeror makes an offer to an offeree and intends to make the offer to that offeree, but the offeror is mistaken about the true identity of that offeree. For example, the offeror may believe the offeree is actually a different person with the same name. Agreements formed in this way may be voidable by the offeror in limited circumstances. This is explained in Chapter 7 ("Other Contract Formation Problems"), Section 7.3, which discusses agreements formed because of mistake.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.3 discusses agreements formed because of mistake.

2.8b Multiple Offerees May Accept an Offer Even If the Offeror Thought (and Hoped) Fewer of Them Would Accept

As discussed above, when an offeror makes an offer, the offeror gives the power to accept to any offerees to whom she intentionally directs that offer. So if there are many intended offerees, all of those intended offerees have the power to accept, unless the offeror has imposed some limit on the number who can do so in the offer.

So when an offeror makes an offer to more than one offeree, more than one offeree can accept it and create a contract with the offeror. This can be a problem for offerors who really thought they would be making only one contract, or a limited number of contracts. The consequences can be very difficult for offerors who really had only a limited ability to do what they offered to do in their offers.

In a way, this is not really an exception to the general rule about intended offerees, but only a part of it, since the parties who are accepting in this situation are intended offerees. The offeror's real mistake here is simply creating too many intended offerees!

Offerors must accept the results of that mistake. Although the law does much to protect offerors, it is up to the offeror to protect herself in situations like this. For example, the offeror might limit the offer when she makes it, either by limiting the number of offerees, or by saying clearly that only a certain number of acceptances will create contracts (such as the first 10 acceptances). An offeror might also try to protect herself by revoking the offer as soon as she receives enough acceptances. But it is not always easy to do that.

*** ***CASE STUDY 70***

FACTS The Big Bear Beer Corporation created a big prize program in order to promote its introduction of Big Bear Beer in big new bottles. The company placed big advertisements in the country's four biggest newspapers, and on big television stations. The advertisements promised a big $1,000 prize to every person who could spell her family name using the Roman letters that the company would engrave, using a secret process, on the inside of each bottle cap. The company promised to print a new letter in its bottles at least once each month.

Immediately after the first advertisements appeared, sales of the new bottles of Big Bear Beer skyrocketed. In the first two months, the company printed the letter "I" and the letter "G." But no one came in with proper identification documents to show that her family name was either "IG" or "GI." In the next month, the company printed the letter "X," and again no one came. The fourth month, the letter "Q" did not create any winners.

At the same time, sales of the beer continued to increase, and the company was extremely pleased.

But after the company printed the letter "N" during the fifth month, people started coming to the company with the "N" and "G" bottle caps, and documents which showed that their family name was "NG." By the end of the second week, over 500 people had come in, and each demanded the $1,000 prize.

The directors of Big Bear Beer realized that they had a big problem. They had not anticipated how many people had the family name "NG." They had not limited the prize offer to one person per family. They had not restricted their offer to citizens of one country. In fact, they had not restricted their offer at all! They immediately placed big advertisements revoking the offer in the same newspapers and on the television stations. But they feared that their company already owed over $500,000 to all those "NGs"--and the company had only budgeted $100,000 for the entire program that year!

QUESTION OF LAW Did all the "NGs" who tried to accept before Big Bear Beer's revocation have the power to accept and make a contract with the company?

DECISION Yes. All the offerees who met the requirements in Big Bear Beer's offer could accept and form contracts, because they were all intended offerees--even though the company did not expect so many acceptances.

When an offeror directs her offer to a group, any member of the group may accept the offer while it is open, unless there is some limit in the offer itself. In this case, the Big Bear Beer Corporation's advertisements were offers which the company made to the general public. And according to the terms of the offers, the offers could be accepted by anyone who could spell her family name using the letters that the company printed on its bottle caps. If there were 500 members in that group, then any or all of those 500 could make a contract with the company by accepting the offer while it was open.

In this case, Big Bear Beer did not restrict the number of offerees or acceptances. And the company only terminated its offer after it had already received more than 500 acceptances by people who could spell their name ("NG") with the bottle caps. Those acceptances were from offerees who had all properly received an offer from the company, and who properly responded to it while it was still open. So all those who met the requirements in the offer made proper acceptances, which formed contracts with Big Bear Beer.

2.9 In Order to Properly Accept a Unilateral Contract Offer, the Offeree Must Perform the Act Requested

When an offer requests a specific act--an offer for a unilateral contract--an offeree can accept only by actually performing the act. There is no contract until the offeree does that, although part performance may cause the offer to be irrevocable for a reasonable time, as explained in Section 2.4d above.

For example, suppose Heng makes a unilateral contract offer to Sambath, saying he will pay Sambath $200 if Sambath rebuilds the broken wall around Heng's house. In that situation, a proper acceptance occurs only when Sambath finishes rebuilding the wall.

This basic rule about acceptance of unilateral contract offers can be divided into two important elements:

(1) the offeree must fully perform the act requested (Section 2.9a); and

(2) the offeree need not notify the offeror about her acceptance unless the offeror requests it, or in some jurisdictions if the offeror has no adequate way of learning of the performance (Section 2.9b).

2.9a In Order to Accept a Unilateral Contract Offer, the Offeree Must Fully Perform the Specific Act Requested

An offeree can accept an offer for a unilateral contract only by performing the specific act the offeror requested. Of course, if the offeree does not perform the specific act requested, the offeree has obviously not accepted the offer.

So there is no contract when, in response to an offer that is clearly for a unilateral contract, the offeree just makes a promise, or performs an act that is different from the act the offeror requested. Of course, a different promise by the offeree can be a counter-offer back to the offeror. But it is not an acceptance, and it does not create a contract.

*** ***CASE STUDY 71***

FACTS Borai goes to the Samaki Real Estate Agency in order to buy some land. Borai says to one of the real estate brokers there, "If you find me a good shophouse near the market and I actually buy it, I will pay you 5% of the house's price as a finder's fee." The agent agrees. He says that he knows many shophouses for sale and is sure that he can find one Borai will like.

Two weeks later, the real estate broker is eating noodles in the market and reviewing the list of available shophouses that he has prepared for Borai. While the broker is doing this, he sees Borai in the garage of a building

across the street. Borai comes and tells the agent, "Never mind about a shophouse for me. I already found that one over there by myself."

Now the Samaki Agency is suing Borai, claiming Borai violated his contract obligation to pay Samaki if the broker found a building Borai liked.

QUESTION OF LAW Did Borai and Samaki have a contract together?

DECISION No. There was no contract between Borai and the agency, because the agency never accepted Borai's unilateral contract offer.

In order to accept a unilateral contract offer, the offeree must fully perform the specific act requested. In this case, Borai promised to give the Samaki agency a commission if Samaki found him a shophouse he liked and actually bought--a specific act. This was an offer for a unilateral contract. Samaki never performed this act. Borai's offer did not ask for a promise, so the promise from Samaki--to look for and find a shophouse--did not properly accept Borai's offer. Here the only way Samaki could properly accept Borai's offer was if Samaki actually did find a shophouse and Borai bought it. That did not happen. Borai revoked first. No (proper) acceptance = no contract.

It does not matter that the Samaki broker had already looked for a shophouse for Borai, and had even prepared a list for Borai to consider. In fact, the result in this case would be the same even if the Samaki broker had worked full time every day for those two weeks just trying to find a shophouse for Borai. The result would also be the same even if the broker found and showed Borai five shophouses which Borai decided not to buy! What matters is that Samaki had no legal obligation to look for a shophouse. Neither Borai nor Samaki had any legal obligation. So there was no contract here.

*** ***WHY IS THIS IMPORTANT?*** Why is it important to know how this rule about acceptances of unilateral contract offers applies in client-broker situations?

It is important for several reasons. First, such situations are common. Many clients and brokers in free market jurisdictions have arrangements similar to Borai and Samaki in Case Study 71. In fact, there are a great variety of important client-broker relationships. Many of the transactions of such clients and brokers are worth a great deal of money. Parties who may form such relations include:

- individuals, businesses and governments who want to buy, sell, or rent property;
- individuals, businesses and governments who want to buy or sell securities;

- parties who want to buy or sell art; and
- employers and individuals who want to make employment contracts.

In addition, the rule has important legal effects. Clients in many jurisdictions generally have no obligation to pay their brokers unless they have specifically agreed to do that. This is because, as in Case Study 71, the relationship between clients and brokers is often based on the client's offer for a unilateral contract. So if there is no other arrangement between the client and the broker, then there is no contract between them, unless the broker performs the act that the client requested. So many brokers try to make a contract with their clients that specifically requires the client to pay the broker for her efforts, even if the broker does not achieve the final result the client wants.

Finally, the rule has important economic effects. When brokers face the possibility that they might do a lot of work and not get paid for it (as in Case Study 71), they often compensate for that risk by raising the price that they charge their clients. For example, if a broker knows that she will work for four clients but probably get paid by only one of them--because she will probably be able to do exactly what only one of the clients wanted--then the broker will probably make sure each client agrees to pay her a high price (commission) if the broker succeeds. The broker decreases her risk by transferring some of the cost of that risk to the client who must pay her the higher commission.

As explained earlier, it is not enough for the offeree to perform some part of the act requested: the offeree must fully perform the act requested. Logically, if only a completed act is an acceptance of an offer to create a unilateral contract, then an act which is not completed is not an acceptance.

In practice, this rule could have unjust effects if the offeree started performing the requested act, but the offeror changed her mind about the offer before the offeree finished the act. So even though such part performance cannot create a unilateral contract, many jurisdictions say that it often does make the offer irrevocable for a reasonable time after the offeree has started the performance requested. That way, although there is still no contract yet, the offeree gets a reasonable opportunity to finish her performance--and accept the offer. This was explained in detail in Section 2.4d above.

However, as noted in Section 2.4d, it appears that this irrevocability rule is not usually applied in situations like client-broker arrangements and reward offers. Most efforts of offerees in these situations--such as those of Samaki in Case Study 71--may not really be considered to be part performance, but only preparation for performance. Such activities may not enrich the offeror--as they did not in Case Study 71. And as in Case Study 71, the offerees probably understand that they are taking the risk that they will work, but they may not be compensated, especially since many offerees may be trying to accept the same offer, even though no more than one can succeed.

2.9b The Offeree Need Not Notify the Offeror about Her Acceptance, Unless the Offeror Requests It, or in Some Jurisdictions If the Offeror Has No Adequate Way to Learn of the Performance

In general, performance of the act requested is all that is required for a proper acceptance of a unilateral contract offer. An enforceable contract is created the moment that the offeree finishes the act that the offeror requested, and no notice to the offeror is required, since the contract already exists at that point. This is very different from the rules about bilateral contracts, which require communication of acceptance from the offeree to the offeror, as explained in Section 2.10 below.

However, there are two important exceptions to the general rule that offerees need not tell offerors about their acceptances of offers for unilateral contracts. These exceptions are:

(1) the offeree must notify the offeror of the acceptance (performance) if the offeror specifically requests it; and

(2) some jurisdictions say the offeree must use reasonable efforts to notify the offeror of the offeree's acceptance (performance) if the offeror has no adequate way of learning of the performance.

If one of these exceptions applies and the offeree fails to notify the offeror, she cannot enforce the contract. But the general rule remains: the offeree generally need not notify the offeror of an acceptance for a unilateral contract.

*** ***CASE STUDY 72***

FACTS One day a 12-year-old girl named Puth disappeared. Her father, a business person named Son Soy, her mother, and the neighbors looked everywhere, but could not find her. Two days later, Son Soy hired a man who had a loudspeaker in a cart to walk around the streets, broadcasting a detailed description of Puth and her disappearance, including what she was wearing the day she disappeared, and also offering a $1,000 reward from Son Soy for information which resulted in the return of his daughter.

The next morning, a cyclo driver named Kan Tip heard the broadcast while he was taking two people to the train station. As Tip's cyclo passed the cart of the man making the broadcast, Tip noticed the woman in his cyclo quickly putting a krama over the face of the unhappy little girl next to her in the cyclo. When the cyclo arrived at the train station and Tip's passengers got out of the cyclo to pay, Tip suddenly realized that the little girl looked a lot like the description he had heard in the broadcast earlier, and that she was wearing exactly the same clothes!

Immediately, Tip rode as fast as he could back to the man with the cart. Tip told the man what he had seen. Twenty minutes later, Son Soy and

the police found Tip's passengers on the queue for the train and rescued Puth. The police told Son Soy that they had found Puth because of Tip's information. The police arrested the lady for kidnapping, and made plans to bring her before a judge as soon as possible.

But when Tip went with the cart man to claim the $1,000 reward later that afternoon, Soy refused to pay, saying: "You never told me that you would look for my daughter, and I never hired you. I made an offer, but an offer is not an obligation. Anyway, I know the police would have found my daughter without your help. You will get nothing from me. Go away!"

QUESTION OF LAW Did Tip's actions create a contract that requires Soy to pay Tip the $1,000?

DECISION Yes. Tip properly accepted Soy's unilateral contract offer by providing the information which enabled the police to find Puth and return her to her family.

Offerees can properly accept unilateral contract offers by performing the specific act requested, and there is generally no need to notify the offeror of performance. In this case, Soy offered to pay a reward to anyone who performed the specific act of providing information leading to the return of his daughter--a unilateral contract offer. Such offers are accepted--and a contract exists--the moment that an offeree fully performs the act for which the offeror offered the reward. And as in most reward offers, Soy made his offer to the general public: anyone who heard the offer was an offeree who could try to do what Soy wanted and claim the $1,000. Tip heard Soy's reward offer and accepted it by giving the police the information which resulted in the return of Puth. This created a contract. And under the general rule, Tip did not need to do anything else to accept Soy's offer. Tip did not have to make any communication or agreement with Soy.

And in this case, neither of the potential exceptions which might require Tip to notify Soy apply. Soy did not ask to be notified of performance. And Soy had an adequate way to learn of it--Soy learned of Tip's performance from the police when his daughter was rescued. So there was no need to tell him. Soy must pay the $1,000 to Tip.

Of course, offerees like Tip in Case Study 71 usually do need to tell the offeror that they have completed the act in order to receive what the offeror promised in the offer (in that case, the $1,000 reward). But such communications are not generally needed to make an acceptance and create the unilateral contract: the contract already exists.

Although bilateral contracts are generally considered to be more common than unilateral ones, there are still some important types of contracts which are often unilateral. Some of the more important types of contracts that are often unilateral are those based on:

(1) reward offers (as in Case Study 72);

(2) agency (client-broker) offers (as in Case Study 71); and

(3) loan offers.

Of course, even such contracts can be bilateral. As explained above, each offeror can choose whether she wants to make an offer for a unilateral contract or a bilateral contract.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3b discusses unilateral and bilateral contracts.

2.10 In Order to Properly Accept a Bilateral Contract Offer, the Offeree Must Properly Communicate the Promise Requested

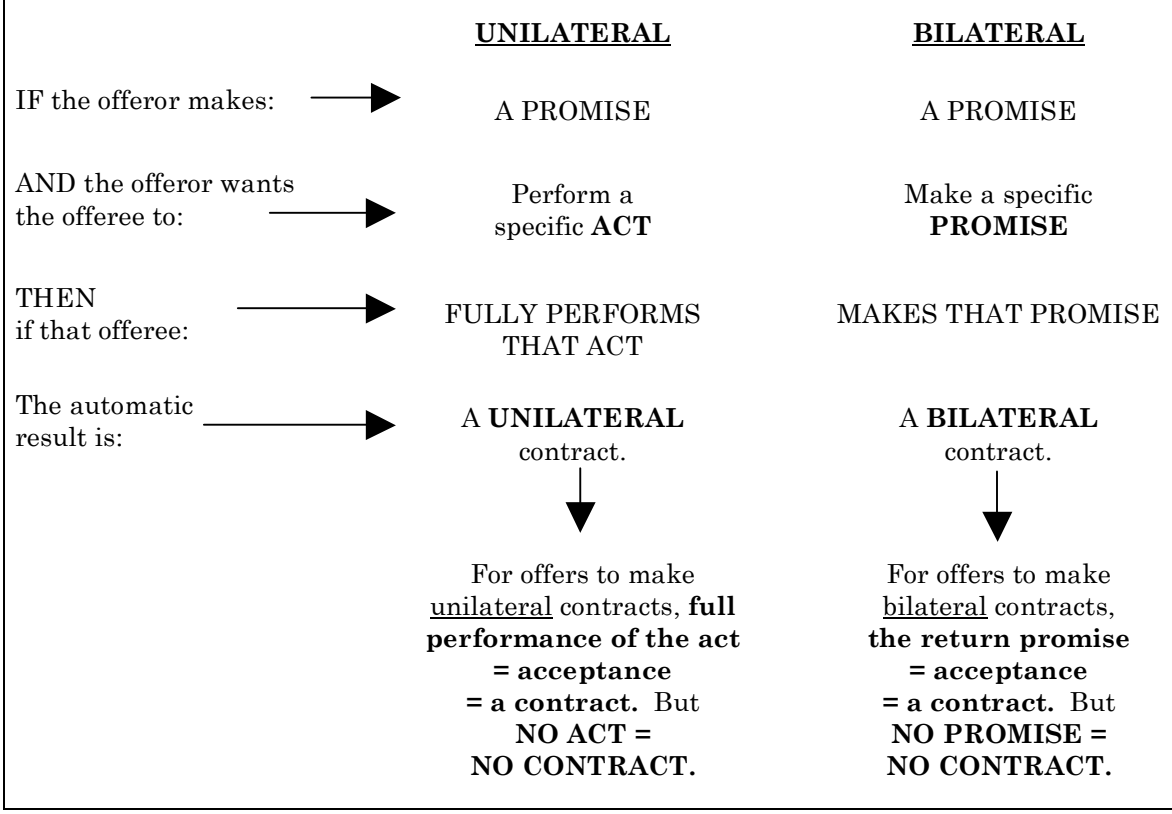
As explained above, a bilateral contract is formed by the exchange of a promise for a promise. It is generally believed that most contracts in the world today are bilateral, especially in modern business. In order to properly accept an offer to create a bilateral contract, the basic requirement is that the offeree must properly communicate the promise the offeror requested.

For example, suppose Reasmey wants to sell her house and Kalyann wants to buy it. Reasmey offers to sell the house to Kalyann for $50,000. The parties then sign a standard legal form which includes all the terms related to the purchase of the house. In this situation, Kalyann will probably give Reasmey her promise to pay $50,000 on a specific date, in exchange for Reasmey's promise to give Kalyann the house and its ownership documents the same day. Their contract is bilateral--not unilateral--because each party is making a promise in exchange for the other party's promise.

The following chart compares acceptances in unilateral and bilateral contracts.



Illustration: Acceptance in Unilateral vs. Bilateral Contracts



Offers to create bilateral contracts can be accepted only by a promise by the offeree. But as explained in Section 2.7, this promise can be made in words or conduct. So an act can be a proper acceptance of a bilateral contract offer when the offeree's actions clearly demonstrate the promise the offeror wanted. This is called an implied promise. Consider the following Case Study.

*** ***CASE STUDY 73***

FACTS Sochua owned a tourist agency in Phnom Penh. A big part of Sochua's business was arranging plane visits to Angkor Wat for groups of tourists. In fact, Sochua spent an average of two weeks each month up at Angkor Wat, leading these tour groups and acting as their guide.

The night before taking a group of tourists up to Siem Reap, Sochua decided that her agency should rent a van on a long term basis, to transport clients from their hotels in Phnom Penh to the airport and back again when they returned from Siem Reap. Sochua knew a taxi driver named Him Youn, who also drove a van sometimes if there were a lot of passengers. Sochua had hired Youn to drive to the airport several times before. So Sochua contacted Youn and described her plan. First, she told Youn that she needed him and his van to go to Pochentong the next day, for their regular fee. Then she said that if Youn promised to meet her at the airport with a van every time she returned from Siem Reap, and to be her agency's full time driver every time

she was in Phnom Penh during the next year, she would promise to pay him $200 every week of the year.

Youn thanked Sochua but said nothing else about the offer. The next morning, he took Sochua and her clients to the airport. Later, Youn decided that the $200 per week salary would be a very good salary, especially during all the weeks when Sochua would not even be in Phnom Penh! So at the end of the week, Youn told Sochua's secretary that he would pick up Sochua's group at the airport. Sochua was surprised to see Youn, but happy when he brought everyone home.

However, the next day Youn was surprised when Sochua told him that she had hired a different van and driver to work for her full time--although she had agreed to pay this new driver less money. Sochua paid Youn the regular fee for the two trips he had made. But Youn was very unhappy.

QUESTION OF LAW Did Youn's actions make a proper acceptance of Sochua's offer and create a contract for the whole year with her?

DECISION No. Youn's actions in driving Sochua's one tour group to and from the airport were not enough to be an implied promise to drive for Sochua for the whole year, so there was no proper acceptance of her offer.

Offers for bilateral contracts are properly accepted when the offeree properly makes the promise requested. This can occur through conduct, where the conduct is actually an implied promise to perform the proposed contract.

In this case, Sochua had offered to pay Youn $200 per week if he promised to drive her tour groups to and from the airport for one year. This was a request for a promise, not an act. If Youn promised to meet Sochua at the airport with a van and be her driver for a year, then she would hire him and pay him for that year. Youn did not expressly make that promise. Youn did only a few acts, on two days. The only question is whether Youn's acts--taking Sochua's one tour group to the airport, and then back to their hotels the day they returned--were enough to form an implied promise or not.

Here, Sochua wanted Youn's promise to work for her for a year. But Youn said nothing, and only drove her group briefly on two days! In this situation, there were probably not enough acts to make the implied promise that Sochua wanted. Perhaps if Youn had driven Sochua's groups on many more occasions, an implied promise might have existed. But here Youn did not do enough. No promise (express or implied) = no acceptance = no contract.

Of course, in situations like Case Study 73, there is often a strong possibility that the parties will eventually make a contract, even though the offeree's actions have not formed one. One reason is that, when an offeree performs an act in direct response to an offer, it is normally clear that she wants to make a contract with the offeror. So even though only a promise

from the offeree could create the contract with the offeror, many offerors will treat the offeree's acts as a promise that the offeree will do all that the offeror requested in the original offer. In addition, even if the act by the offeree is not considered a proper acceptance of an offer to create a bilateral contract, it may be a counter-offer from the offeree to the offeror. So it is then possible for the offeror to make the contract with the offeree by treating the offeree's act as a counter-offer--and then accepting it. Unfortunately for the offeree Youn in Case Study 73, the offeror Sochua did not do that. Section 2.5b of this Chapter contains further discussion of counter-offers.

As explained above, in order to properly accept a bilateral contract offer, an offeree must properly make the promise the offeror requested. This fundamental rule can be divided into four important general requirements. These requirements are the subject of the rest of this Section. Specifically, a proper acceptance of a bilateral contract offer must generally:

(1) be communicated to the offeror (Section 2.10a);

(2) be unequivocal and unconditional (Section 2.10b);

(3) be identical to--or "mirror"--the terms of the offer (Section 2.10c);

AND (4) occur in a proper manner, including meeting any special requirements of the offeror (Section 2.10d).

The rules about when acceptances are effective, which can be complex, are discussed in Section 2.10e.

2.10a First Requirement: The Offeree Must Communicate Her Acceptance to the Offeror

An offeror makes an offer to create a bilateral contract because she wants to receive a particular promise from the offeree. So if the offeree really wants to accept the offer--and create a contract--the offeree normally must make that promise to the offeror! But if an offeree does not communicate her acceptance (her promise) to the offeror, there is no contract between them.

******* ***WHY IS THIS IMPORTANT?*** What is the effect of the basic rule that requires an offeree to communicate her acceptance to the offeror in order to create a bilateral contract?

This rule about communication of acceptance to make a bilateral contract is one of the most important rules of contract law. This is because the key to a contract is the voluntary agreement of the parties, and the communication of agreement is what shows this agreement. An offeror demonstrates her consent to the terms of a contract when she makes her offer. An offeree demonstrates her consent to the terms of a contract when she makes her acceptance. So no consent (offer) from the offeror = no contract. No consent (acceptance) from the offeree = no contract.

This rule can also have a big effect on parties who ask courts to resolve contract questions. When there is a dispute about real agreement, the first thing courts look for before they enforce contracts is some clear indication of consent by all sides of the contract. Of course, it is often easy to see the offeror's consent: the offeror made her offer, either for a unilateral or bilateral contract, so she obviously wanted to make the contract. But sometimes the more difficult question is: did the offeree consent? In bilateral contracts, only a promise from the offeree can demonstrate her consent to the contract. Courts look for that promise before they consider enforcing a contract against either the offeror or the offeree. And courts will not generally enforce a bilateral contract unless the evidence shows that the offeree communicated her promise to the offeror.

Words are probably the most common way parties communicate acceptances of bilateral contract offers. Human communication often requires words. And offerees often use words to communicate their acceptances of offers to create bilateral contracts.

However, as explained in Section 2.10 above, parties can also communicate their acceptances of bilateral contract offers through conduct. Of course, people may also communicate without words. So it is also possible--in certain circumstances--for an offeree to use conduct to communicate her acceptance, and create a bilateral contract.

Silence is generally not a proper acceptance of an offer for a bilateral contract. That is because silence usually does not communicate the promise the offeror wanted.

However, silence can be a proper acceptance in several special situations. In particular, silence can be a proper acceptance of an offer for a bilateral contract because of: a prior agreement about it between the parties; prior similar dealings between the parties; a relevant trade usage or industry practice; or substantial use or control of the subject matter of the contract.

These rules about communication of acceptance will be discussed in more detail in the following Sections.

(1) Words Are Probably the Most Common Way Parties Communicate Acceptances of Bilateral Contract Offers

In general, offerees actually use words to communicate their acceptances to the offeror. Of course, the offeror cannot be expected to just guess or assume that the offeree has made the acceptance. That could be a big problem for the offeror--or unfair to the offeree if the offeror were wrong about such a guess. The offeree also cannot just assume that she has made a contract with the offeror--unless she actually makes the promise to the offeror. Obviously, if the offeree does not tell the offeror, the offeror may have no way to know that her offer has been accepted! It is not enough that the offeree

think about or even decide to accept an offer--she must communicate her acceptance.

******* ***CASE STUDY 74***

FACTS After two weeks of negotiation, Leap makes a final, written offer to sell her rights in a very profitable market stall to Suor, if Suor promises to pay Leap $30,000. Suor is pleased, because although he cannot afford to pay a higher price, he will be able to borrow enough money to pay the $30,000 in Leap's final offer.

Suor decides to accept, and tells his friends that he is going to buy the market stall. He intends to send a note to Leap telling her that he accepts. But he forgets to send the note, because he is so busy arranging loans. In fact, Suor only has $5,000 of his own money, so he spends the next week arranging loans for the other $25,000. He borrows $20,000 from several of his relatives and $5,000 from a bank. He signs documents with each of the lenders in which he promises to repay the loans within two years at an annual interest rate of 20%.

But when Suor goes to give the $30,000 to Leap, Leap tells Suor that she has already sold her market stall rights to a man named Ya Ya. Suor then goes and explains his story to Ya Ya, but Ya Ya says "No No" when Suor demands the market stall from him.

So Suor sues Leap and Ya Ya in court: Leap for breach of contract, and Ya Ya for wrongful interference with a contract. Leap says he had a contract with Suor. Suor asks the court either to enforce the contract by ordering Leap to sell him the rights to her market stall (specific performance), or to order Leap and Ya Ya to compensate Suor for the money Suor will lose because of the loan obligations he now has.

QUESTION OF LAW Was there a contract between Leap and Suor?

DECISION No. There is no contract because, even though Suor intended to accept Leap's offer to sell him the market stall, he failed to communicate his acceptance.

An acceptance of a bilateral contract offer must be communicated to the offeror to be proper. Offerees often use words to do that. In this case, Suor decided and intended to communicate his acceptance of Leap's offer to sell him a market stall using words. He even told his friends. But he forgot to tell Leap! Leap's potential contract to sell her market stall to Suor depended on Suor's communication of the promise that she had requested: the promise to pay $30,000 for the stall. Here, although Suor intended to communicate this promise to Leap, he did not actually do so. So there was no acceptance of Leap's offer. No acceptance = no contract.

As Case Study 74 illustrates, if an offeree wants to make a bilateral contract, it is not enough that she decides to accept, intends to accept, or even tells others that she will accept. The offeree must communicate her acceptance to the offeror. Words are often the best way to do that.

(2) Parties Can Communicate Their Acceptances of Bilateral Contract Offers through Conduct

Although most people use words to communicate, people also sometimes communicate by their conduct (without words). So the law does not always require that the offeree use words to create a bilateral contract. Sometimes the offeree's conduct can communicate the acceptance necessary to create such a bilateral contract. This is an implied acceptance, and it was already discussed in Sections 2.7 and 2.10 above.

Acceptances through conduct can happen in various ways. Some were discussed in Section 2.7. One example might be where there is a pattern of conduct in response to an offer that communicates the promise requested, as the driver Youn tried but failed to do in Case Study 73. Another example might be an affirmative act or gesture--such as a nod of the head--in response to an offer. And in some cases, the parties make arrangements that mean a particular act--rather than words--can communicate the promise the offeror requested. This will be illustrated below in Case Study 75.

But in all such situations, it is important to remember that the offeror has requested only a promise from the offeree. The offer is for a bilateral (not unilateral) contract. So the offeree's conduct in such cases merely demonstrates the offeree's acceptance of the offer. That is, the offeree's conduct only shows that she is making the promise the offeror requested. It may be part of the performance of the contract, but that is not what makes it an acceptance. It is the implied promise that makes it an acceptance.

******* ***CASE STUDY 75***

FACTS At a meeting with the manager of the Royal Anna Hotel, one of the owners of the Sabai Ice Co. made the following offer: "If you want us to deliver our pure ice to your hotel every morning at 5:00 a.m., put these special ice chests next to your service entrance in the back of the hotel. Our staff will fill the chests with $200 worth of ice, and send you the bill later for that amount. If you do not want the ice, just call us and we will come back to get our chests." The ice maker then gave the hotel manager five enormous ice chests, each of which had the name "Sabai Ice" on the top and side and the special "smiling face" symbol of Sabai Ice.

The manager of the Royal Anna thanked the ice maker for his presentation and the chests. But he did not promise to pay for the ice if Sabai Ice delivered it. He said he would think about the offer, and would probably

decide when he returned from an international hotel conference the following week.

Because of the manager's words, the Sabai Ice driver was surprised the next morning when he saw the chests next to the Royal Anna's service entrance! But he assumed the manager had decided to accept before he left for his conference. So he filled the chests with ice, and did the same for six days.

However, after seven deliveries had occurred, the hotel manager called the owner at Sabai Ice and asked why Sabai Ice had delivered the ice when the hotel manager had not consented to the contract! The owner said that the hotel had, in fact, indicated its consent by putting its chests outside the service entrance door. The owner then asked to whom he should send the $1,400 bill for the ice.

QUESTION OF LAW Did the hotel's conduct create a contract which now requires it to pay Sabai Ice?

DECISION Yes. The hotel's conduct in putting the ice chests out beside the hotel indicated that it was accepting Sabai Ice's offer to provide ice, so a contract existed between the parties for the ice deliveries that were made.

An offeree can accept a bilateral contract offer through conduct where that conduct shows that the offeree is making the promise the offeror requested. In this case, even though the manager of the Royal Anna Hotel did not use words to accept the offer from Sabai Ice, the hotel did precisely the act which Sabai Ice and the manager both knew would indicate the hotel's acceptance of the offer for the bilateral contract--the act that would make the implied promise. The offer said the only thing the hotel needed to do to accept the offer was to leave the five ice chests next to its service entrance. So according to the offer itself, that conduct was acceptance: it was the implied promise to pay for the ice.

In this case, the hotel performed that act--and so made the implied promise--by putting the ice chests out for seven days. So a contract existed for those deliveries between the hotel and Sabai Ice. The hotel must pay for the ice Sabai Ice delivered.

In situations like Case Study 75, it is important that both sides of such potential transactions understand which special act or form of conduct by the offeree will demonstrate that she accepts the offer. And of course, the offeror generally cannot choose some ordinary conduct of the offeree and say "If you do that, that means you accept my offer and we have a contract!" For example, the offeror cannot say the offeree will indicate acceptance if the offeree just parks her moto in the usual place, or eats rice at a restaurant! The act must be something the offeree would not normally do unless she wanted to accept the offer--like putting an ice company's ice chests outside a hotel service entrance.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3d contains further discussion of express and implied agreements.

(3) Silence Is Generally Not a Proper Acceptance of an Offer for a Bilateral Contract

As discussed above, a proper acceptance of a bilateral contract offer generally requires some words or conduct from the offeree showing that she really wants to make that contract with the offeror. So if an offeree is completely silent, and does not communicate in any normal way her acceptance to the offeror, there is generally no contract. That is because this lack of a response to an offer generally does not communicate the promise the offeror requested. So it generally does not create an acceptance.

*** ***WHY IS THIS IMPORTANT?*** Why is silence by an offeree generally not a proper acceptance of an offer to create a bilateral contract?

There are important legal and practical reasons for this general rule. The legal reason is that it is generally unlikely that an offeree who is silent about an offer really intends to accept the offer. In fact, the offeree's silence normally demonstrates her "non-acceptance" of the offer! Reasonable offerors know that. The practical reason is that the law does not want to force offerees to respond to every offer directed at them in order to avoid accepting. On the contrary, valid contracts are generally based only on affirmative responses from the offeree, not a lack of a response.

This general "silence is not acceptance" rule also has important effects. It protects both offerors and offerees from misunderstandings in cases where the offeree does not respond. And the rule protects offerees from fraud and abuse by offerors. That is because the rule generally prevents offerors from taking advantage of offerees who do not want to respond, cannot afford to respond, do not know how to respond negatively, or forget to reject an offer. This protects offerees against exploitation by aggressive sellers of books (such as encyclopedias), publications, electronics, cassettes, tickets, insurance, securities and other investments, and religious and medical goods. So sellers cannot profit by sending or offering their product to someone who has not asked for it, and then--without the offeree's consent--saying to the offeree: "If we do not hear from you, then you agree to pay us for our product." Under the general "silence is not acceptance" rule, the recipient of such products (the offeree) normally has no obligation to pay the seller (offeror) for the products. In fact, special laws in some jurisdictions (such as in the United States) say that a person who receives goods through the mail in this manner does not even have to return the goods. These laws further protect consumers from abusive sales practices by some sellers.

The following case illustrates the protection which even commercial offerees can receive from the general rule that silence is generally not an acceptance.

*** ***CASE STUDY 76***

FACTS The Two-Ight Cinema bought a one-year, $1,000,000 fire insurance policy from the Everguard Insurance Company, and paid Everguard a $2,000 premium for the policy each month. The parties had never dealt with each other before. And the policy did not contain any provision for automatic renewal of the insurance contract.

One month before the end of the year, Everguard sent a letter to Two-Ight which included a renewal of the policy for the next year on the same terms, along with a bill for the $2,000 premium for the first month of the new year. Everguard's letter stated that Two-Ight had to notify Everguard before the end of the year if Two-Ight did not want to renew its insurance on those terms.

Two-Ight, however, did not contact Everguard or do anything else regarding the letter or insurance from Everguard. Two months later, Everguard demanded $4,000 (for two months of insurance), which Two-Ight had not paid. Everguard also insisted that Two-Ight continue to pay $2,000 per month for the rest of that year under what it said was the renewed insurance policy. When Two-Ight refused and denied they had a contract together, Everguard sued Two-Ight.

QUESTION OF LAW Did Two-Ight's silence create a contract with Everguard?

DECISION No. Two-Ight's silence in response to Everguard's renewal offer was not an acceptance of Everguard's offer to renew the insurance policy, so there was no new contract here.

Silence is generally not an acceptance of an offer for a bilateral contract, no matter what the offeror claims. The law generally does not allow offerors to put offerees in a position where the offerees' failure to respond creates a contract. In fact, an offeree generally has no obligation to respond to an offer, unless that offeree agrees to such an obligation.

In this case, Everguard sent an offer for Two-Ight to renew the fire insurance policy the parties had together. The offer basically said that if Everguard did not hear from Two-Ight, then there would be a new insurance contract between the parties. Two-Ight did not respond. In this situation, it does not matter that Everguard's letter said that Two-Ight's silence would be acceptance. Everguard did not have the legal power to impose that standard on Two-Ight. And there was no evidence in this case that Two-Ight had agreed that its silence would be acceptance. Two-Ight and Everguard had no history

of making contracts together in that way, and there was no automatic renewal provision in the first insurance policy. So Two-Ight never accepted Everguard's offer of the new policy. No acceptance = no contract.

(4) Silence Can Be a Proper Acceptance Because of a Prior Agreement, Prior Similar Dealings between the Parties, a Relevant Trade Usage or Industry Practice, or Substantial Use or Control of the Subject Matter

Despite the general rule that silence is not acceptance, there are a few special situations where an offeree's lack of a response to an offer can actually communicate the acceptance needed to create a bilateral contract. In these special circumstances, silence actually becomes a form of communication!

Specifically, this text will discuss four situations in which an offeree's silence--her lack of affirmative words or conduct--in response to an offer can by itself create a bilateral contract with the offeror. These four situations occur where silence can be an acceptance because of:

(1) a prior agreement between the parties;

(2) prior similar dealings between the parties;

(3) a relevant trade usage or industry practice; or

(4) substantial use or control of the subject matter of the contract.

These special situations are discussed below.

(1) Prior Agreement -- Silence in response to an offer for a bilateral contract can be a proper acceptance if the parties previously agreed or consented that silence would be acceptance.

This kind of prior agreement between the parties may be express or implied, or partly both. For example, suppose an offeror makes an express offer. The offeree says, "If you do not hear from me in five days, I accept your offer," and the offeror agrees. In that case, the offeree's silence during those five days will create a valid contract.

But if there is no such prior agreement or understanding between the parties, the offeree's silence generally will not create a contract. So there is usually no contract when an offeror just tells the offeree (without the offeree's consent): "If you do not contact me to reject this offer, then we have a contract."

This first exception is based on some express or implied agreement between the parties. Both sides agree in some way, in advance, that no response to the offer is an acceptance of the offer. However, in the other three exceptions explained below, the law implies from the surrounding circumstances that the offeree's silence in those particular circumstances was really an acceptance of the offer.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3d contains further discussion of express and implied agreements.

(2) Similar Prior Dealings -- Silence can be a proper acceptance of a bilateral contract offer if similar prior dealings between the parties would indicate to a reasonable person that a contract could be formed in that way. Sometimes parties develop a way of dealing with each other in which silence can be acceptance as long as the offeree has a reasonable opportunity to object to the offer. Consider the following Case Study.

*** ***CASE STUDY 77***

FACTS For five years, the Doh Wing-Doh Mohk Taxi Company (DWDM) brought its cars to the same mechanic whenever they needed to be repaired. The mechanic's habit was to check the broken car first, and then, before doing any repair work, notify the owner of DWDM about the problem and how much it would cost to fix it. Although DWDM's owner often contacted the mechanic within a day or two to discuss the mechanic's evaluation, or negotiate about the price, sometimes DWDM did not respond. In those cases, the mechanic always did the repair work within a few days, and DWDM always paid him for it according to the estimate.

One day, after checking one of DWDM's cars which the company had left with him, the mechanic sent his evaluation and cost estimate for some major repairs to the brakes and engine. However, the mechanic did not hear anything back from DWDM. On the third day, the mechanic sent a second note, but there was no reply from DWDM for two more days. So the mechanic repaired the car.

At the end of the week, the owner of DWDM came and demanded his car. The owner claimed that he did not have to pay the mechanic anything because he had not accepted the mechanic's offer to do those particular repairs.

QUESTION OF LAW Was the owner's silence an acceptance which created a bilateral contract with the mechanic?

DECISION Yes. Similar prior dealings would show a reasonable person that DWDM's silence for several days in this situation was actually an acceptance of the mechanic's offer to repair the car.

Although silence is not usually a proper acceptance, it can be where similar prior dealings between the parties would persuade a reasonable person that the parties intended to make a contract that way. In this case, the owner of the DWDM taxi company and the mechanic already had five years of similar dealings together. Each time DWDM brought a car to the mechanic, the mechanic evaluated it and notified DWDM. The mechanic's evaluation and

cost estimate was the offer. DWDM then had a reasonable chance to object to the evaluation or price. After waiting a few days, the mechanic repaired the car and DWDM paid for it--sometimes with and sometimes without a normal communication of acceptance from DWDM. So this case was clearly just a continuance of a course of dealing between the parties in which the silence of the offeree (DWDM) indicated his acceptance to the offeror (the mechanic).

In this case, the owner had a reasonable opportunity to reject the mechanic's offer, which the mechanic had delivered to the owner twice in writing, and about which the mechanic had waited five days for an answer. Although the law generally does not require offerees to reject offers that they do not want to accept, in this case the owner was obligated to make a rejection because of his past dealings with the mechanic. So if the owner did not want to accept the mechanic's offer in this case, he should have said so clearly. But he did not. So a contract was formed here. The owner must pay the mechanic for the repair work according to the estimate.

(3) Trade Usage or Industry Practice -- Silence can be a proper acceptance of a bilateral contract offer if some trade usage or industry practice clearly shows that silence can be acceptance in the particular transaction or business activity in which the parties are engaged.

*** ***CASE STUDY 78***

FACTS The Chook Chhay Cigarette Company received 3,000 bales of tobacco and an invoice from a dealer in Kompong Chhnang. The parties made no special arrangements, and they did not communicate with each other in any other way. At the time, the practice in the tobacco industry was that tobacco sellers would send standard quantities of tobacco to bulk buyers like Chook Chhay, who then had up to one month to return to the seller any tobacco with which they were not satisfied. Otherwise, their failure to respond was considered an acceptance.

But Chook Chhay waited three months without saying anything to the dealer, and then returned the tobacco, saying it was damaged and of low quality. The dealer refused to take the tobacco back and demanded full payment from Chook Chhay. The dealer said that he was not sure who might have damaged the tobacco during all that time, but that the reason it was now of low quality was that it had become old and had not been properly stored! The dealer also said it was too late for him to try to do anything with that tobacco now, and that in any case, the parties already had a contract.

QUESTION OF LAW Was the cigarette company's three month silence an acceptance which obligated it to pay the dealer for the tobacco?

DECISION Yes. Chook Chhay's three month silence was an acceptance of the dealer's offer to buy the tobacco because of an industry

practice that Chook Chhay had to respond about the shipment within one month, or else the company's silence would be considered an acceptance.

Silence is not usually a proper acceptance, but it can be where trade usages or industry practices show that offerees can accept that way. In this case, Chook Chhay failed to respond about the tobacco the dealer sent to it for three months, then tried to reject it. In this situation, the cigarette company has the legal obligation to pay the dealer for that tobacco. This is because Chook Chhay was silent throughout the one month period within which the tobacco industry practice at that time generally required buyers to make their rejections. As a result of that industry practice, and in the absence of any different arrangement between the parties, the cigarette company's silence was a proper acceptance. So a contract was formed between the parties.

(4) Substantial Use or Control of the Subject Matter -- Finally, silence can be a proper acceptance of a bilateral contract offer if, under certain circumstances, the offeree substantially uses or controls the subject matter of the offer without otherwise communicating any acceptance. This situation could also be analyzed as a kind of acceptance through conduct, since the offeree is in a way doing something in response to the offer--using or controlling the subject matter.

With respect to property, such use or control is often called "exercise of dominion." That means that the offeree does something that is inconsistent with the offeror's ownership or possession of the property, generally after the parties have discussed the offer in some way. One example related to goods is the situation discussed in Section 2.7 of this Chapter, where a potential car buyer (the offeree) kept and drove the potential car seller's (offeror's) car for a very long time--even though the buyer was supposed to be merely evaluating the car to see if she wanted to buy it! Such use and control is inconsistent with the offeror's ownership of the car, and it may be considered an acceptance of the offer.

Of course, this "use or control" exception does not apply to situations like those described above where aggressive sellers of goods give persons items without their consent, and then claim there is a contract. In such cases, silence is not acceptance, and there is no contract.

******* ***CASE STUDY 79***

FACTS In order to conduct a special economic survey of border provinces, a team of government officials from one of the ministries decided to rent two floors of a privately owned building in the middle of Sisophon. The officials signed a lease with the owner which required the officials to pay the owner $500 in rent at the beginning of each month, for a term of six months.

When the owner came to collect the $500 rent at the beginning of the sixth month, the owner asked the government officials if they would really be

leaving at the end of that month. The officials replied that they were not sure, because they did not yet know if they would be able to finish all of their work by then. The owner told them they could continue to stay in his building for three more months after the original lease term expired, but only if they agreed to pay rent of $900 per month for those extra months. Otherwise, the owner said, the officials would have to leave.

The officials responded that they would have to check with their superiors in Phnom Penh, and they immediately sent a letter there with all the details. However, two and a half months later, the survey team was still in the same building, exactly as before. During that time, they had received no instructions from their superiors, made no special arrangement with the owner, and paid no rent to the owner!

The owner tried, without success, to get from the officials the higher rent which he had told them he would want for those extra months. Finally, the owner sued the government for payment in the appropriate tribunal.

QUESTION OF LAW Was the officials' silence an acceptance of the owner's offer of a lease at the increased rate of rent?

DECISION Yes. The officials' silence was an acceptance of the house owner's lease offer for the additional months, because the officials used and controlled the property during that time.

Silence is not normally an acceptance, but an offeree's use or control of the subject matter of an offer can demonstrate acceptance--even if the offeree does not communicate the acceptance in any usual way or is totally silent about the offer. In this case, a house owner made an offer to extend the lease of some government officials who were in Sisophon doing a survey. The subject matter of the owner's offer was renting the top two floors of his building at an increased price.

The government officials at first neither accepted nor rejected the offer. But though the officials did not communicate acceptance in any usual way, they did use and control those two floors for two and a half months of the period for which the owner had demanded the higher rent! The government officials knew that the six month lease was almost finished, and that they had to respond to the owner's offer of the higher rent if they wanted to stay in the building. This was because the owner had clearly told the officials, one month in advance, about the rent increase, and the fact that the officials would have to leave if they did not want to pay the increased rent. So the government officials clearly had a reasonable opportunity to reject the offer and leave, but they did not. In these circumstances, the officials' silent, continued use of the building was an acceptance of the offer the owner made. So the government must pay the owner the higher rent for the months the officials stayed.

This "use or control" exception also applies to contracts for services, or a combination of goods and services. Sometimes the parties discuss an offer of services for which the offeree knows or should know that the offeror expects compensation. But occasionally the offeree, without making any promise or protest, uses or profits from those services--and then refuses to pay, claiming she never technically "accepted" the offer! In these situations, the offeree's use of and benefit from such services can actually be an acceptance, provided that the offeree had a reasonable opportunity to reject the offer.

*** ***CASE STUDY 80***

FACTS Ker Dak was a photographer who earned a lot of money by selling his pictures of wedding ceremonies and groups to the couples who got married. Although some of the couples hired Ker Dak in advance to take pictures of them the day of their marriage, Ker Dak also went to areas where newly married couples often went to offer his services to the couples there. Specifically, Ker Dak offered to take pictures of the couple and their group, develop them, deliver them to the couple, and charge the couple only a small standard fee, plus a reasonable charge for any pictures that they decided to keep.

One Sunday, Ker Dak politely made his usual offer to a couple he happened to know near the Independence Monument at the fountain. After listening to Ker Dak's plan and prices, the husband told Ker Dak: "You can take the pictures if you want to." Ker Dak helped the couple find good settings and poses for their photos, and took about 100 pictures, developed them, chose the best 30, and delivered them to the couple's house. The couple never objected to his help.

Three days later, the couple told Ker Dak that his photos were a wonderful.... gift, most of which they had already given to their families and friends! When Ker Dak reminded the couple that he expected payment for his photos and his standard fee, the husband told Ker Dak that they had never agreed to pay anything.

QUESTION OF LAW Did the couple have a contract obligation to pay Ker Dak?

DECISION Yes. The couple used the services and kept the goods which Ker Dak provided--encouraging him to take the photos and then keeping them--and this was an acceptance of his offer.

When an offeree uses and profits from goods and services from an offeror, this can be an acceptance of an offer, as long as the offeree had a reasonable opportunity to object. In this case, Ker Dak offered to take pictures of a newly married couple. Although the married couple never promised in any usual way to pay for Ker Dak's photos or pay his standard fee, they used his services and kept the photos, without protest, after discussing with him

his system. The couple had a reasonable opportunity to reject the services and the photos. And the couple knew that Ker Dak expected compensation for his work. So the couple accepted Ker Dak's offer even though they were basically silent about it. Now they must pay Ker Dak his standard fee, and pay for the photos they kept.

However, the key limit on this "use or control" exception for services is the requirement that the offeree had a reasonable opportunity to object but did not do so, either at the time the parties discussed the services or when the offeror provided the services. This is because the exception does not apply in cases where the offeror really just imposed her services on an unwilling offeree. For example, the couple in Case Study 80 would have had no contract with Ker Dak and no obligation to pay if they had told him not to help them or take the pictures.

In addition, it is important not to confuse this "use or control" exception with a quasi-contract. As explained in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5, a quasi-contract is a contract the court imposes only where there is unjust enrichment of one of the parties, even though the parties did not actually make an enforceable agreement together. By contrast, this "use or control" exception says that sometimes a party's "use or control" of the subject matter of an offer can actually be a valid acceptance. Of course, the two ideas are similar in that both are ways contract law tries to prevent unjust loss by parties who have given some benefit to other parties.

*** ***WHY IS THIS IMPORTANT?*** Why can an offeree's silence--lack of affirmative words or conduct--create a bilateral contract in these four special situations?

As explained earlier, the general rule that "silence is not an acceptance" provides great protection to offerees. That is because it limits the ability of offerors to impose contracts on offerees who do not respond to their offers.

These four exceptions, however, provide some protection to offerors. It would be unfair to the offeror to apply the general "silence is not acceptance" rule in all cases. As demonstrated in Case Studies 77-80, the exceptions are needed to reduce the ability of offerees to benefit intentionally from offers, but then deny any obligation to the offerors, just because the offerees did not communicate their acceptances in the usual ways!

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains further discussion of quasi-contracts.

2.10b Second Requirement: The Offeree's Acceptance Must Be Unequivocal and Unconditional

An offeree's acceptance of an offer to create a bilateral contract must show that she really intended to make a contract. Normally that is

not possible if the offeree's response to the offeror is equivocal or contains a condition.

So the second key requirement for a proper acceptance of a bilateral contract offer is that the acceptance must be unequivocal and unconditional. This generally means that:

(1) the acceptance must show that the offeree presently agrees to the offer; AND

(2) the acceptance must not depend on a change or addition to the offer, which would mean that the acceptance was subject to a condition.

These two related elements are discussed in the following Sections.

(1) A Proper Acceptance Must Show the Offeree's Present Agreement

In order to make a proper acceptance, the offeree must indicate that she agrees to the offer now. Some responses by offerees show that they do not presently agree to the offer. For example, it is obvious that an offeree is not ready to make a contract based on an offer if she responds by saying, "I might agree to accept your offer next week," or "Yes, your offer seems to be acceptable," or even "I agree in principle."

For the same reason, offerees do not generally make contracts with responses which are "agreements to agree" about important (material) terms. Such responses are not proper acceptances because they show that the offeree has not yet made a final agreement to the offer, since there are still some material terms which the parties need to agree about in the future. As discussed earlier in Section 2.3b of this Chapter, offers which propose such agreements to agree about important terms are usually not definite enough to be valid offers. Such statements cannot generally create proper acceptances either. However, it is possible that an "agreement to agree" might create some added duty to negotiate in good faith about a final agreement.

(2) A Proper Acceptance Must Not Depend on Any Change or Addition to the Offer

A valid offer gives the offeree the power to create a contract just by properly accepting the terms of that offer. But in order to make such a proper acceptance, the offeree's response cannot depend on any changes or additions to the offer. That would basically mean that the acceptance was subject to a condition, and that it would be an acceptance only if the condition occurred.

As explained earlier, a condition is an if-then relationship of two events: if X happens, then Y will happen; but if X does not happen, then Y will not happen. An offeree makes a conditional acceptance whenever the acceptance depends on something which might or might not happen, such as the offeror's

agreement to a change or addition. That is, the offeree says to the offeror: "If X happens, then I accept your offer." The problem is that if X does not happen, then the offeree does not accept the offer. So even though the offeree's response may look like an acceptance, it is really only a possible acceptance. Such conditional acceptances are not proper acceptances and do not create contracts.

So if the offeree's response to an offer depends on additional or different terms, that response is generally not a proper acceptance--and it may be a counter-offer! The key question is whether the offeree's response actually agrees to the offer but requests changes, or whether the response says there is no agreement unless the offeror agrees to the changes the offeree wants. The following chart compares examples of offeree responses which properly accept the offeror's offer (the left column) with examples of offeree responses which do not properly accept the whole offer, but are in fact counter-offers (the right column).

Illustration: Acceptance of Offer vs. Counter-Offer

		ACCEPTANCE	COUNTER-OFFER
1.	**Offeree's response**	"We accept your offer, but we would like to add the following terms..."	"This letter is an acceptance only if you agree to the following additional terms."
		--or--	**--or--**
		"I do not really like your offer, but I agree."	"I accept your offer if you change it like this..."
2.	**Nature of such responses**	Unconditional response.	Conditional response.
3.	**Role in formation of a contract**	Proper acceptance.	Counter-offer.
4.	**Effect**	Offeree immediately creates a bilateral CONTRACT.	NO CONTRACT yet, but original offeror can create a contract if she accepts the counter-offer.

However, some authorities appear to say that not all statements requiring future events in an offeree's response prevent that response from being a proper acceptance. According to such authorities, it is possible for an offeree to make a proper acceptance which shows her agreement even though the response appears to require some future formal event which is not directly related to performance of the contract. It appears that some authorities do not consider such acceptances to really be conditional.

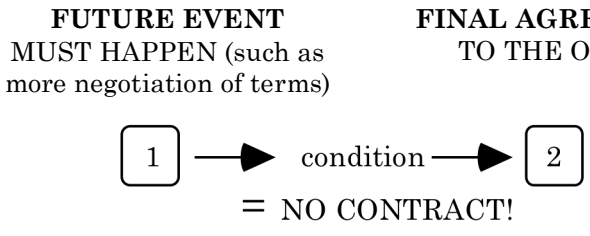
The most common way for this to happen is where an offeree appears to agree to the offer, but wants to put the agreement in some different written form later. For example, an offeree may say to the offeror, "I accept subject to our preparation of a document which records this agreement." In such cases, the future event (the "preparation of a document") does not relate to further negotiation of the terms of the offer. It would appear that the offeree does agree to the terms of the offeror's offer. As a result, some authorities say there is a contract, even though it appears that the offeree's agreement depends on some future event.

But if the offeree refers to writing some document that might change the important terms the parties have already discussed, or if the offeree wants to put the terms discussed in a document that must be approved by someone else (such as a lawyer), there may not be a valid acceptance--because there may not be a present agreement. Of course, whether the offeree presently agrees can be a difficult question, which the court in each case must decide based not only on what the offeree says, but also on all the surrounding circumstances.

Some authorities appear to apply this rule even where the offeree agrees to the offer subject to the preparation of a document including "whatever other related terms are reasonably necessary," or some similar statement. This kind of response by an offeree can apparently be a proper acceptance if it indicates an intent to be presently bound by the terms the offeror has already proposed. Of course, the "reasonably necessary" terms will generally be standard terms which are commonly found in similar contracts, and which are related to the existing terms, such as the place of delivery in a sale of goods contract. They would seem to be the kind of terms that a court could supply where the parties did not state them, as discussed in Section 2.3b above, and as will be further explained in Chapter 8 ("Interpretation of Contracts"), Section 8.3j. They cannot be terms that would change the existing terms, or that only the parties could determine, such as the identity of goods to be sold.

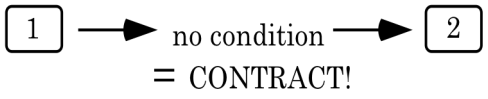
Illustration: What Happens When an Offeree's Response Describes a Future Event: Two Possibilities (A and B)

Possibility A. When the offeree says that she **agrees only if a particular event happens first**, generally there is no contract. This is because that future event is actually a condition which prevents the offeree's response from being a proper acceptance.



Possibility B. When the offeree says that she **agrees to the offer, but requires that a particular formal event happen later**, some authorities appear to say there generally is a contract. This is because the future event is not considered to be a condition that must occur in order for the contract to be formed.

FINAL AGREEMENT TO THE OFFER	**FUTURE EVENT TO HAPPEN** (such as putting the agreement in some different written form)



*** ***CASE STUDY 81***

PRELIMINARY FACTS The White Star Company sent a letter offering $1,000,000 to the owner of land opposite the University of Phnom Penh. The owner decided to accept the offer, but she wanted a formal written contract.

POSSIBLE FINAL FACTS:	QUESTION OF LAW	DECISION
The owner gave White Star a letter which said:	**Is that a proper acceptance?**	**Result**
1. "I agree subject to a document acceptable to our lawyers."	Probably not a proper acceptance, because the offeree and her lawyers may still want to negotiate terms of the offer.	Probably NO contract. This is like "A" in the Illustration above.
2. "I agree subject to contract."	Probably not a proper acceptance unless the circumstances show that the offeree has already agreed to the terms of the offer.	Probably NO contract. This is usually like "A" in the Illustration above.
3. "I agree subject to White Star's preparation of a document which reflects this agreement and whatever other related terms are reasonably necessary."	Probably a proper acceptance, according to some authorities. The offeree has expressed final agreement to both the terms of the offer and any related terms which are reasonable and necessary.	Probably a CONTRACT, according to some authorities. This is usually like "B" in the Illustration above.
4. "I agree subject to writing this agreement."	Probably a proper acceptance, according to some authorities.	Probably a CONTRACT, according to some authorities. This is usually like "B" in the Illustration above.

One potential problem with the above rules is the use by offerees of phrases like "subject to." Technically, if the offeree's "agreement" is "subject to" any future event which is not certain to occur--even an apparently minor event such as the creation of a document stating what the parties have already "agreed"--that is still a condition. And the offeree is saying she does not agree unless that condition is fulfilled. The parties can be fairly confident the law will imply reasonable terms where the parties have omitted them. But how can they be sure that one or both parties will actually create some document in the future? So arguably such an offeree response is still conditional, and there is not really a final agreement yet.

It would appear that courts applying the above rules would have to interpret language such as "subject to" as not creating a condition, or as not creating a "serious" condition that should prevent an agreement. It is not clear what would happen if the parties actually failed to create the later writing. And if the court would enforce the agreement anyway, it is not clear what remedy the offeree would have where her demand for a writing was not followed. Nor is it clear why the offeror should be required to do something--such as write an agreement--which she never agreed to do.

Of course, if the offeree says the agreement is "subject to" some future event and the offeror then agrees, there is no problem. In that situation, the parties have a contract obligation to make the future event happen.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3j contains further discussion of contract terms courts may supply where the parties did not state them.

2.10c Third Requirement: The Offeree's Acceptance Must Generally Be Identical to the Offer

An offeree generally does not make a proper acceptance of an offer if she tries to accept that offer with new or different terms in her acceptance--if her acceptance is not identical to the offer. Such offeree responses generally do not create contracts. In fact, such offeree responses generally terminate the offeror's offer, because they are not acceptances, but counter-offers. This was already discussed in Section 2.10b above, and in Section 2.5b on counter-offers.

This Section first discusses the general requirement that acceptances of bilateral contract offers must be identical to the offer. Then it explains a very important exception that some jurisdictions make for sale of goods contracts.

(1) A Proper Acceptance Must Generally Be Identical to--a "Mirror Image" of--the Offer

In order to form a contract with an offeror, the offeree's acceptance must generally be identical to the terms in the offeror's offer--like a reflection in a mirror. So this important rule is often called the "mirror image rule.

It generally applies to all kinds of contracts except, in some jurisdictions, contracts for the sale of goods. The basic reason for the mirror image rule has been explained before: the offeree is not really agreeing to an offer if her response to that offer shows that she does not agree to the offer's terms, or that she will agree only to something else.

*** ***CASE STUDY 82***

FACTS After several interviews, Cambodioil, Inc. offered Mey Munty the job of manager of its Kompong Som operations. Cambodioil offered Munty a salary of $1,000 per month, health and life insurance, and two weeks annual vacation time.

Munty knew that was a good offer, but he decided to try to negotiate for an even better one. So the next day he told Cambodioil that he accepted their offer at $1,200 per month and three weeks annual vacation time. That night, Munty invited all of his relatives and friends to celebrate his good luck at a big dinner, which he arranged and paid for at the fine restaurant on Koh Pohs Island.

But Munty was upset when he found out two days later that Cambodioil had hired someone else to be the manager in Kompong Som! Now Munty asks that the court order Cambodioil to either hire him or pay him compensation for the damage he suffered as a result of Cambodioil's failure to hire him.

QUESTION OF LAW Did Munty's response create a contract with Cambodioil?

DECISION No. Munty did not make a proper acceptance of Cambodioil's offer because his response was not identical to the offer.

In general, an offeree can create a contract with the offeror only if her response to the offer is identical to the offer--a mirror image. If the offeree tries to accept that offer with new or different terms, the offeree has generally only made a counter-offer, not a contract.

In this case, Munty tried to accept Cambodioil's offer of a job in Kompong Som and change important parts of that offer at the same time. When an offeree does that, the offeree has not accepted the offer. Instead, the offeree has created and then tried to accept her own offer! Here, Munty did not accept the $1,000 monthly salary that Cambodioil offered him. In fact, he tried to accept his own offer of $1,200 per month. And Munty did not accept the two weeks of vacation time that Cambodioil offered him--he tried to accept his own offer of three weeks of vacation time. Responses like Munty's are not proper acceptances, because they are not identical to the offers they claim to accept. So they do not create contracts. No acceptance = no contract. Cambodioil has no obligation to Munty.

The result of this general rule is that if <u>any part</u> of the offer is not accepted, there is no contract. And it generally does not matter how small or unimportant a term seems to be: the offeree must accept all the terms if she wants to immediately create a contract with the offeror.

******* ***CASE STUDY 83***

<u>FACTS</u> On the last day of October, the leader of the New Khemara Party decides she would like to organize a huge party in the Luxury Hotel in Phnom Penh in order to celebrate Cambodia's Independence Day, and also introduce to the public the 40 candidates running on the party's ticket in the upcoming Parliamentary elections. The leader describes her plan to the candidates, and tells them that each candidate can bring 20 of his or her most important friends and supporters.

The party leader approaches the hotel manager and makes an offer. Specifically, the leader says that she wants the use of the hotel ballroom, entertainment, and the excellent meal that the hotel serves for such big events. The leader says she also wants the following: 80 tables seating 10 persons each, 20 cases of Green Label whiskey, 1,000 cartons of Downhill brand cigarettes, and one big cake shaped like the Independence Monument with a Cambodian flag on top. The party leader offers to pay the hotel $40 per person for all this.

The manager of the Luxury Hotel tells the party leader that he will check. Two days later, the manager sends the party leader a note saying, "I accept your offer. The meal and the cake will be exactly as you ordered, and delicious as usual. However, I will prepare 100 tables for 8 persons, and we will serve White Label and Harsh 6 brand cigarettes. Thank you for your business!"

The party leader is annoyed. She immediately contacts a local restaurant, which agrees to provide everything exactly as the leader wants, and the leader holds the event there instead. The event is a big success. And although the manager of the Luxury Hotel and all of his staff vote for the candidates of a different party in the election, many of the New Khemara candidates win. But the hotel sues the New Khemara party and its leader for breach of contract.

<u>QUESTION OF LAW</u> Did the Luxury Hotel manager's attempted acceptance of the party leader's offer create a contract?

<u>DECISION</u> No. The hotel manager did not accept what the party leader had offered, so no contract was formed between the hotel and the party.

An offeree's response must generally be identical to--a mirror image of--the offer in order to create a contract. So the offeree cannot choose which terms she likes and insist on adding or changing others!

In this case, the leader of the New Khemara Party made an offer to the Luxury Hotel. But the hotel manager (the offeree) only accepted some of the terms in the party leader's (offeror's) offer. Specifically, although the offer asked for 80 tables for 10 persons each, the hotel manager's response said the hotel would provide 100 tables of eight; instead of Green Label whiskey the manager said he would provide White Label; and instead of Downhill cigarettes, the manager said he would provide Harsh 6 brand cigarettes. So the response was not identical to the offer. And the party leader did not agree to the different terms with which the hotel manager tried to accept her offer. So the party leader did not accept the hotel manager's counter-offer. There was no proper acceptance in this case, and no contract.

(2) Some Jurisdictions Say a Proper Acceptance of an Offer for the Sale of Goods May Not Need to Be a Mirror Image If It Is a Definite Expression of Acceptance

In offers which are mostly for the sale of goods, it is not always necessary for the offeree to accept exactly what the offeror offered in order to create a contract. This is an important exception to the general mirror image rule.

Specifically, some jurisdictions basically say that an offeree can properly accept an offer for the sale of goods if her acceptance is a definite expression of acceptance--even if it includes new or different terms! This exception may be contained in special commercial laws that govern sale of goods transactions.

A "definite expression of acceptance" would appear to basically mean that the offeree's response shows that she really, presently agrees to the offer, with no doubts or conditions. Basically, it would seem to mean about the same thing as the "unequivocal and unconditional" requirement discussed in Section 2.10b above. It is possible to make such a response while still changing terms in the offer. For example, an offeree might say: "I definitely accept your offer at 500 riels"--even though the offer was actually for 400 riels.

Of course, even though this kind of exception means a mirror image is not always needed to create a sale of goods contract, proper acceptances must still be fundamentally similar to the offer. If an offeree's response is not, then it is not really a "definite expression of acceptance." This is because there must be some limit to how different a response can be and still be considered an "acceptance." A response that is too different from an offer cannot be a proper acceptance, no matter how "definite" it claims to be. For example, an acceptance to buy cashews is probably not an acceptance of an offer to sell beans! This limit will vary in every situation. And since different jurisdictions have different laws, it is important to check the specific law that applies to each transaction to see if this exception applies, or if it applies in a different way from what is described below.

One example of a commercial law that contains this sale of goods exception is the Uniform Commercial Code ("UCC") in the United States. This text will use the UCC as an example to show how such an exception works in some jurisdictions. Of course, this type of exception may differ in other jurisdictions.

In any event, under the UCC, there are basically two important questions to ask in order to understand how the exception works:

(1) Is a sale of goods contract formed even though the offeree's response contains new or different terms?

AND (2) If a sale of goods contract is formed in this special way, then what happens to the new or different terms in the acceptance?

These key questions are discussed in more detail below.

(a) Is a Sale Of Goods Contract Formed Even Though the Offeree's Response Contains New or Different Terms?

Under the UCC, in order for an offeree's response to a sale of goods offer to be a proper acceptance, it must be a definite expression of acceptance, even if it contains terms that differ from the offer.

The following chart compares the requirements for acceptance of sale of goods offers under the UCC to the general mirror image rule discussed earlier.

Illustration: Mirror Image Rule vs. UCC Sale of Goods Exception

	Requirement for the offeree's response to be a Proper Acceptance	**Is there a contract when the response adds to or changes terms of the offer?**
1. **Offers generally** for all kinds of contracts except sale of goods contracts in some jurisdictions.	**General Rule:** The offeree's response must be **IDENTICAL** to the offer (a **mirror image**).	**NO CONTRACT!**
2. **Offers for the sale of goods** under the UCC.	**Exception:** the offeree's response need only be a **DEFINITE EXPRESSION OF ACCEPTANCE**--even if the response includes new or different terms. So a **mirror image** is not required.	**a. If the offeree's response satisfies this requirement:** **CONTRACT!** (status of new or different terms discussed below) **b. If the response does not satisfy this requirement:** **NO CONTRACT!** (because the offeree's response is probably just a counter-offer)

Consider how this sale of goods exception applies in the following Case Study.

******* ***CASE STUDY 84*** **(applying UCC)**

FACTS After much negotiation, a purchasing agent gave a letter to a sales officer of the Pokambor Supply Company with an order for "50 Enginola portable telephones, at $1,000 each, delivery 30 days, 90 days credit." Pokambor accepted the order at the stated price in a note to the purchasing agent which also said "60 days delivery, 60 days credit."

The purchasing agent did not like those terms and decided to buy the telephones from some other seller. But Pokambor insisted that even though it had changed some terms of the purchasing agent's offer, Pokambor had properly expressed its acceptance, and the agent was legally required to buy the telephones.

QUESTION OF LAW Did Pokambor's acceptance create a contract with the purchasing agent?

DECISION Yes. Pokambor's response was a proper acceptance because it was a definite expression of acceptance of an offer for a sale of goods contract, even though some of its terms differed from those in the offer.

In jurisdictions with laws like the UCC, an acceptance of an offer for a sale of goods contract is proper if it is a definite expression of acceptance, even if it includes new or different terms. In this case, Pokambor sent a response to the purchasing agent's offer to buy mobile phones which accepted the offer but included different credit and delivery terms. This response actually created an enforceable contract. In this case, involving the sale of goods, Pokambor's response was a definite expression of acceptance--even though it changed the delivery term (from 30 days to 60) and the credit term (from 90 days to 60) in the purchasing agent's offer. Proper acceptance = contract. However, the new terms can only become part of the contract in very limited circumstances. That will be explained below.

This sale of goods exception allows an offeree to accept an offer--and create a contract--and include a new or different term at the same time! Because of this exception, such a response by the offeree can create a contract.

The exception can also be dangerous for offerees who are not careful, or not familiar with these rules. Such offerees may end up creating contracts where they did not think they were! And the terms in that contract are likely to be the offeror's terms. As explained in the next Section, the new or different terms such offerees include will only become part of the contract in very limited circumstances.

(b) If a Sale of Goods Contract Is Formed in this Special Way, Then What Happens to the New or Different Terms the Offeree Put in Her Acceptance?

In jurisdictions with laws like the UCC, a new or different term that an offeree includes in her acceptance of an offer for a sale of goods contract only becomes part of the contract in very limited circumstances. Whether the offeree's new term becomes part of the contract depends on several things. They are not easy to understand. They include whether the offeree's acceptance makes a "material change" in the offer, and whether both parties are "merchants." The exact rules for what happens to the new or different term are explained below. But first the text will explain what commercial laws generally mean by "material change" and "merchant."

*** **DEFINITION:** A **material change** is a new or different term which gives one party significantly greater benefits, rights, or advantages (and the other party less) than she had before.

So if the offeree's acceptance includes a new or different term which will give her significantly more benefits, rights, or advantages (and the offeror less) than the offeror offered, then that acceptance makes a material change in the offer. But if the offeree's response includes a new or different term which does not significantly increase or decrease the benefits, rights, or advantages in the offer, then that acceptance does not make a material change. What will be a "material change" will differ in every contract, based on all the circumstances. But common examples include changes in the contract terms as to the price, quantity or quality of goods.

*** **DEFINITION:** A **merchant**, for this purpose, is basically a person who normally deals in goods of the kind involved in the transaction being analyzed.

Now this Section will examine the rules for whether the offeree's new or different terms become part of a sale of goods contract. It should be--and is--more difficult for a term that makes a material change to become part of a contract than for a term that makes a non-material change. So contract laws like the UCC have two separate formulas to determine whether such changes become part of the contract.



(1) Non-Material Changes

Basic Formula for Incorporation of Offeree Terms Which Make **NON-MATERIAL** Changes to the Offer for the Sale of Goods (UCC)

If the offeree makes a **definite expression of acceptance** of a sale of goods offer, and the acceptance contains a new or different term which does not make a material change in the offer, then:

THE CONTRACT CONSISTS OF:

(A) THE **ORIGINAL TERMS** IN THE OFFER;

PLUS **(B)** **ONLY IF** the following three elements are present, then the contract includes **THAT NEW OR DIFFERENT TERM**. The three elements that must exist are:

(1) both parties are **merchants**;

(2) the offer **does not expressly limit acceptance to its terms**;

AND (3) the offeror **makes no objection** within a reasonable time to the new or different term in the offeree's response.

That is, a term that does not make a material change will become part of the contract only if the parties are both merchants, the offer does not expressly prohibit the change, and the offeror does not reject the change within a reasonable time. So in this special situation, even the offeror's silence can allow the new or different term to become a part of the contract.

But if even one party is not a merchant, or if the offer prohibits the change, or if the offeror objects within a reasonable time, then the new or different term does not become part of the contract! So it is really not so easy for the new non-material term to become part of the contract.

(2) Material Changes

Basic Formula for Incorporation of Offeree Terms Which Make **MATERIAL** Changes to the Offer for the Sale of Goods (UCC)

If an offeree makes a **definite expression of acceptance** of a sale of goods offer, and the acceptance contains a new or different term which makes a material change in the offer, then:

THE CONTRACT CONSISTS OF:

(A) THE **ORIGINAL TERMS** IN THE OFFER;

PLUS **(B)** **ONLY IF** the offeror **agrees** to the new or different term, then the contract will include **THAT NEW OR DIFFERENT TERM**.

So if the offeror does not actually agree to a new or different term making a material change, then that term does not become part of the contract. Terms which make important changes do not become part of the contract just because the offeror is silent or does not object! So it is even harder for terms that make material changes to become part of the contract. Offerors must agree to them.

Compare the following two Case Studies. Case Study 85 illustrates the application of the rule for terms which make immaterial changes to the offer. Case Study 86 illustrates the operation of the rule when the offeree makes a material change.

******* ***CASE STUDY 85*** **(applying UCC)**

FACTS Bo's Photo Shops, Inc. sent an order to buy 20 "HI-TK" video cameras to the Filmex Corporation in Singapore for a special price of $6,000, with Filmex to cause delivery to occur within 90 days by the Carryall Co., a reputable delivery service. Both Bo and Filmex normally bought and sold this kind of goods in their businesses. Filmex decided to accept Bo's order. It immediately sent one of its standard, pre-printed order acknowledgment (acceptance) forms to Bo.

In the appropriate spaces on the acknowledgment form, Filmex had written the name, number, and price of the video cameras Bo ordered, and a date for delivery within 90 days of Bo's order. But Filmex had not written the name "Carryall Co." for delivery, because Filmex always used the Rapid Transit Company (another reputable delivery service) for all its deliveries, and Filmex's pre-printed order acknowledgment form already said that. Bo received and read the acknowledgment from Filmex, but did not say anything.

About eight weeks later, however, Bo decided that his shops should buy a different video camera from a different supplier. So Bo sent a letter to Filmex to cancel his order. But Filmex refused to cancel the order, and delivered the 20 video cameras to Bo using Rapid Transit. Filmex then demanded that Bo pay for the 20 video cameras according to his obligation under their contract. Bo responded by saying that Filmex had never properly accepted his offer because Filmex had changed the term for delivery--and then actually used the wrong delivery service--without his approval. Filmex sued Bo for breach of contract.

QUESTION OF LAW Did Filmex's acceptance create a contract with Bo's Photo Shops which allowed Filmex to use Rapid Transit to deliver the video cameras?

DECISION Yes. In this case: (1) Filmex's response created a contract because it was a definite expression of acceptance; and (2) that contract allowed Filmex to use Rapid Transit to deliver the video cameras, because

the change Filmex made was immaterial, and all the legal requirements for the change to become part of the contract are met.

(1) The Contract -- Acceptances need not always be identical to offers ("mirror images") in order to create a contract. In some jurisdictions, in offers for the sale of goods, it is only necessary for an offeree to make a definite expression of acceptance in order to create a contract with the offeror. In fact, in such cases, a contract exists even if the offeree's acceptance tries to add or change the terms in the offer!

In this case, Bo made a written offer to Filmex which described the identity, quantity, price, and delivery arrangements for a purchase of video cameras--an offer for the sale of goods. Filmex sent a definite expression of acceptance, even though it changed one of the terms in the offer. As a result, Bo and Filmex immediately had a contract together.

(2) The Different Term -- But to determine whether this kind of contract consists of just the original terms in the offer, or also the new or different term(s) in the offeree's acceptance, it is necessary to decide whether the new or different term(s) made a material change or a non-material change. In this case, the only term that Filmex tried to change in its acceptance was the delivery service term in Bo's offer. In offers for the sale of goods, such terms are normally not material (important) unless either a party or the special circumstances of the case indicate that they are.

Here, neither Bo nor the circumstances of the case indicated that delivery by Carryall was a material term of the offer. Most reputable delivery services are comparable, and according to Bo's offer, Filmex had full responsibility for delivery. If Bo really had a special reason for Filmex to use only Carryall to deliver the video cameras, then Bo should have said that. He did not. So Filmex's use of Rapid Transit instead of Carryall would probably not significantly decrease the benefits, rights, or advantages that Bo had anticipated when he made his offer. Filmex's acceptance had made a change in Bo's offer which was not material.

Under the sale of goods exception for acceptances, a non-material change in the offeree's acceptance will become part of the contract if both parties are merchants, and the offer does not limit acceptance to its terms, and the offeror does not object within a reasonable time. Here, both Bo and Filmex were merchants who regularly dealt in this kind of goods, the offer had no such limits, and Bo was silent for eight weeks after Filmex's acceptance said it would use Rapid Transit to deliver the cameras. So Filmex's delivery service term (to use Rapid Transit) became part of the contract.

In this case, Filmex had the right to use Rapid Transit to deliver the video cameras to Bo. And Bo has the obligation to pay for them.

******* ***CASE STUDY 86*** **(applying UCC)**

FACTS The Thambon Import-Export Co. offered in writing to sell a huge Model AX-900 generator to the Yum Noodle Factory for $86,000, with delivery in 60 days, and payment half on delivery, half within the 90 days following delivery. The chairman of the board of Yum Noodle wrote a letter saying, "We at Yum are pleased to accept your offer of the generator. It will be necessary for you to install it behind our processing plant, because we do not have the trained people or the proper equipment to do that." Thambon scheduled a date for the delivery of the generator with the factory manager, but said nothing about the installation.

Thambon delivered the generator, and Yum paid $43,000. A week later, Yum's chairman called Thambon to find out when they would install the generator. When Thambon told the chairman of Yum that Thambon had never promised to install the generator, the chairman refused to pay the second $43,000 until they did. So Thambon sued Yum for payment.

QUESTION OF LAW Did Yum's acceptance impose on Thambon the contract obligation to install the generator for Yum?

DECISION No. In this case: (1) Yum's response did create a contract with Thambon because it was a definite expression of acceptance; but (2) the installation term Yum stated did not become part of the contract, because it was a material change and Thambon did not agree.

(1) The Contract -- First, although there is normally no contract unless the offeree's acceptance perfectly matches the offeror's offer, some commercial laws make an exception for the sale of goods. According to this sale of goods exception, an offeree may properly accept an offer and state additional terms at the same time. When such an offeree makes a definite expression of acceptance, she immediately creates a contract with the offeror.

Here, Thambon's offer to Yum was for the sale of goods (a generator for $86,000), and Yum clearly agreed to Thambon's offer. And though Yum's chairman said in his acceptance that he also wanted Thambon to install the generator, a term which was not in the offer, the chairman did not specify that his acceptance of Thambon's offer "depended on" that installation (or any words to that effect). Yum's words were not conditional. So the two parties had a contract together for the purchase and sale of the generator for $86,000.

(2) The Additional Term -- But additional or different terms in an offeree's response to a sale of goods offer do not always become part of the contract. In fact, it depends on whether the new or different term would make a material change or not. If the additional term would make a material change in the offer, then that term will become part of the contract only if the offeror actually agrees to it.

Here, the additional term that Yum included was for the installation of the generator. In addition to selling and delivering the generator, Yum wanted Thambon to send trained people and special equipment to install the generator at Yum's factory. In fact, Yum was asking Thambon to provide that service, the expertise and labor, and whatever other materials were needed for the installation at no extra cost to Yum! This additional term would significantly increase the benefits, rights, and advantages of Yum, and significantly decrease those of Thambon under the contract. So it made a material change.

Additional terms that make such material changes become part of the contract only if the offeror actually agrees. But here the offeror Thambon did not agree! Thambon said and did nothing except to deliver the generator as required by the contract. So installation never became part of the contract. Thambon is not obligated to install the generator, and Yum must pay what it still owes for the generator.

*** ***WHY IS THIS IMPORTANT?*** Why do some jurisdictions allow offerees to create sale of goods contracts even though their acceptances are not identical to all of the terms in the original offer?

Some jurisdictions believe that this exception recognizes how people and businesses actually make sales contracts. When people buy and sell goods, they often make contracts which are based on offers and acceptances that are not "mirror images!" In fact, people have rarely done their business or made their sales contracts in such a precise way. Parties have often relied more on trade usage, industry practices, course of dealing, and their relationships in order to make their sales contracts. So they have not needed--or wanted--to always have acceptances that were the perfect mirror image of their offers. The strict general rule, which used to apply to all offers and acceptances, said there was no contract in such situations because of the new or different term in the acceptance. But the strictness of that rule was a burden on sales activity. It interfered with the normal way that people negotiate and make sales agreements. And it also gave bad offerees a way to deny real contract obligations by saying that they had never properly accepted an offer!

So some special laws now provide an exception for sale of goods offers. Under the exception, there is a contract if the offeree has made a definite expression of acceptance of a sale of goods offer. And it does not matter that the offeree's acceptance did not perfectly match the offer, or included a different or additional term. In fact, in limited circumstances, that different or additional term might even become part of the contract!

The exception also solves the problem of the "battle of the forms." Many buyers and sellers (especially big businesses and governments) use pre-printed forms in their sales activities, such as purchase order forms, order confirmation forms, and acknowledgments. Like Filmex in Case Study 85, these parties often use such forms to make their offers and acceptances.

Of course, when a buyer and a seller each use their own pre-printed forms, their forms will often differ in some ways! But even if the pre-printed forms differ, there often is a real agreement between the parties. The strict general rule would not recognize that agreement. But the sale of goods exception does recognize such agreements. So the sale of goods exception does not let such real sales agreements "die" in the "battle of the forms!"

This exception also promotes commerce. In a world of fast and extensive commercial activity, the sale of goods exception lets parties create sales contracts without extraordinary attention to every detail of every term. The result is generally more sale of goods contracts and more trade.

Of course, there are some potential problems with the rule discussed in this Section. One is that it may be difficult for courts and parties to decide just how "fundamentally similar" an offeree's response must be in order to be an acceptance. Another potential problem is that it may sometimes be unfair to an offeree who responds with different terms, thinking she has made a counter-offer, but finds that she has actually made a contract on the offeror's terms! Of course, such offerees should not make responses that could be interpreted as "definite expressions of acceptance" unless they are prepared to follow the offeror's terms. Finally, it could be argued that offerors should never be required to object to changes from the offeree--even non-material ones--since that would mean they are not "masters of their offers." Of course, it is difficult to create rules that have no potential problems. On the whole, sale of goods exceptions like this appear to have worked fairly well in practice.

2.10d Fourth Requirement: The Acceptance Must Occur in a Proper Manner, Including Meeting Any Special Requirements of the Offeror

In order to be proper, acceptance must occur in a proper manner. In particular, offerors may require or request that offerees accept in a certain manner. Offerees generally cannot ignore these offeror statements and still make a proper acceptance.

For example, an offer may say the offeree must accept the offer in writing by a certain date in order to make a contract based on that offer. In that case, the offeree must accept the offer in writing by that date, or lose the power of acceptance.

Offerors sometimes describe a specific manner for an offeree to accept the offer if the offeree wants to create a contract. In this Section and Section 2.10e, this text will use the word "manner" to mean the entire way an offeree conveys an acceptance to the offeror, including the way the acceptance is transmitted (such as by fax, messenger, or telephone), the physical nature of the acceptance (such as whether it is oral or in writing), and the timing of the acceptance (such as whether it occurs by a certain date).

Basically, if the offeror does require only one manner of acceptance, the offeree must accept in that manner, or the acceptance is not proper. But if the offeror does not insist on just one manner--whether because the offer merely suggests a manner, or because it says nothing about manner of acceptance--then the offeree must use a manner that is reasonable under the circumstances. Of course, these basic rules are similar to those about how long an offer lasts, as discussed in Section 2.6a with regard to lapse.

The following Sections discuss how offerees can make proper acceptances of these different kinds of offers.

(1) If the Offeror Expressly Insisted on Only One Manner of Acceptance, the Offeree Must Comply in Order to Make a Proper Acceptance

Sometimes the offeror expressly insists on just one specific manner of acceptance, such as a writing or a face-to-face communication. In that situation, that specific manner of acceptance is the only way for the offeree to make a proper acceptance of that offer.

*** ***CASE STUDY 87***

FACTS Malin mailed an offer to Bunthet which stated: "If you wish to accept, you must fax your acceptance before the end of this week to my agent Choo Choo in Taiwan. No other manner of acceptance is possible."

Bunthet quickly decided to accept. But he could not find Choo Choo's fax number. So he faxed his acceptance to Malin and mailed a copy of the fax to Choo Choo. But Malin was out of the country on business and did not know that Bunthet had sent him the fax. The following Tuesday, Choo Choo called Malin to say that he had just received by regular mail a copy of the acceptance that Bunthet had faxed to Malin. Malin told Choo Choo to ignore it.

QUESTION OF LAW Did Bunthet's attempted acceptance create a contract with Malin?

DECISION No. Bunthet did not make a proper acceptance because he failed to accept in the proper manner.

In order to make a proper acceptance where offerors expressly insist on one manner of acceptance, offerees must accept in that manner. In this case, Malin clearly limited the manner of acceptance of his offer to Bunthet to one way: a fax to Choo Choo. He said, "No other manner of acceptance is possible." Bunthet failed to comply with that requirement. It does not matter that Bunthet sent the fax to Malin as fast as he would have sent the fax to Choo Choo, or that Bunthet actually succeeded in informing Choo Choo by mail, because neither of those ways was what Malin had required

for acceptance of his offer. So the acceptance was not proper. No proper acceptance = no contract.

As Case Study 87 shows, what the offer says about the manner of acceptance is important. But it may not always be easy to determine when an offeror is "expressly insisting" on only manner of acceptance. In many jurisdictions, an offeree must comply with the precise manner the offer specifies if the offer uses expressions like those which are underlined in the sentences below:

- "If you want to accept, you must respond only by mail."
- "Acceptance absolutely not valid unless received before the first of next month."
- "Your signature on this form is the essential and exclusive means of acceptance."

OR
- "No contract until offer accepted in person."

In such cases, the offeree has no other way to make a proper acceptance of the offer, unless the offeror changes her requirement. Of course, in practice, offers rarely insist on just one special manner of acceptance.

(2) If the Offeror Did Not Expressly Insist on Only One Manner of Acceptance, the Offeree Must Use a Manner That Is Reasonable under the Circumstances

If the offer did not clearly require just one manner of acceptance, then the offeree has some freedom in choosing how to accept the offer. In that case, the offeree can use any manner of acceptance that is reasonable under the circumstances.

What is "reasonable under the circumstances" may not always be clear, and legal authorities do not always seem to agree about it. Therefore, this Section will attempt to present some of the general ideas in this difficult area. Generally there are two possible ways for offerees to make "reasonable" acceptances where offers do not strictly require one manner of acceptance.

(1) Offer Suggests a Manner of Acceptance -- If the offer suggests (but does not expressly insist on) a particular manner of acceptance, then it is reasonable for the offeree to accept diligently either by that manner, or any other manner which is generally similar to or better than the manner that the offer suggested.

"Similar or better" usually means an acceptance made in a manner that is generally as fast, reliable and otherwise satisfactory as what the offer suggests. For example, if the offer asked for (but did not demand) an acceptance by mail, the offeree may properly accept the offer by sending her acceptance either by mail (the suggested manner), or by a reliable

delivery service, telegram or fax, which are usually better because they are faster, more reliable, or both.

Sometimes the offeror's suggestions may look very strong, such as when the offeror says, "accept this way," or "you should accept this way." But in many jurisdictions, these are still only considered "suggestions" unless the offeror clearly says that the manner specified is the only permissible way, using words like "only" or "essential," as discussed above.

Sometimes an offeree can even make a valid acceptance when she does not diligently use a manner which is generally "similar to or better than" the way the offeror suggested. However, if the offeree chooses to try to accept in such a manner, that manner must actually succeed at making the acceptance at least as well--as quickly, reliably and otherwise satisfactorily--as the manner suggested by the offer. Otherwise, the acceptance will generally not be effective. So if the offeree in the example above sent the acceptance by a manner that was generally even slower than the mail (such as a cyclo from Phnom Penh to Battambang), the acceptance would probably not be effective if that manner actually turned out to be slower. And some manners of acceptance are not as reliable or otherwise satisfactory as the manner the offeror suggested no matter what actually happens. For example, an offeror who requests a written acceptance will probably not be satisfied with an oral acceptance, no matter how fast it arrives.

Consider the possibilities in Case Study 88.

******* ***CASE STUDY 88***

POTENTIAL FACTS AND RESULTS

IF:	AND THEN	QUESTION OF LAW		DECISION
Mr. Fer wrote to Mr. Free:		**Was that a proper acceptance?**		**Result**
1. "I should receive your acceptance by mail."	Mr. Free sends a telegram, which arrives more quickly than the mail would.	YES.	=	CONTRACT.
2. "Send a messenger with an answer to this offer by noon today."	Mr. Free comes himself before noon and accepts.	YES.	=	CONTRACT.
3. "Acceptance on reverse side of this form."	Mr. Free sends a separate letter of acceptance with the form.	YES.	=	CONTRACT.

IF:	AND THEN	QUESTION OF LAW	DECISION
Mr. Fer wrote to Mr. Free:		**Was that a proper acceptance?**	**Result**
4. "Call me immediately if you want to accept."	Mr. Free faxes an acceptance, but the fax does not arrive at Fer's fax machine until three days later.	NO. = Mr. Free tried to use a different manner which was not similar to the manner Fer suggested, and which turned out to be worse (slower).	NO CONTRACT.
5. "Written acceptance no later than midnight Monday."	Mr. Free calls Fer on Monday before midnight and accepts.	NO. = Mr. Free chose a manner that was different from what Fer had suggested--and probably not as reliable or satisfactory.	NO CONTRACT.

(2) Offer Does Not Suggest Any Manner of Acceptance -- Sometimes the offer neither insists on nor suggests a specific manner of acceptance. Of course, this is very common. In this situation, the offeree must generally accept in a manner that is reasonable based on:

(a) the subject matter of the offer;

(b) the manner in which the offeror made the offer; AND

(c) any other relevant circumstances.

These rules are briefly discussed below.

In this situation, the manner of acceptance must be reasonable based on the subject matter of the offer. Sometimes some of the other rules explained in this text may affect what is a reasonable manner of acceptance in this situation. For example, it would seem that acceptance of an offer for the sale of land might need to be written to be reasonable, since most jurisdictions require contracts for the sale of land to be written in order to be enforceable. However, as with some of the offer termination rules discussed in Section 2.6, the real problem here might seem to be a different formation requirement--formality--rather than real agreement. In addition, an offer for a currency exchange contract would probably require an immediate acceptance. This is because offers for this kind of subject matter usually expire quickly, because the rates of exchange of currencies generally change so quickly. This has already been explained as part of the rules about lapse which were discussed

in Section 2.6a. Of course, a manner of acceptance is probably not reasonable if it results in the offeree trying to accept an offer that is no longer valid.

The manner in which the offeror made the offer is also an important part of the analysis of whether an acceptance is reasonable. Generally, the offeree should make her acceptance in the same manner that the offeror made the offer, or one that is generally similar or better. For example, if the offeror made the offer in a mailed letter, the offeree should normally mail a written acceptance back to the offeror, or use a manner that is generally similar or better (like a reliable delivery service) if she wants to be sure her acceptance is proper. The offeree may be able to accept in a different manner that is not generally similar or better. But such an acceptance will generally be proper only if it turns out be basically as fast, reliable and otherwise satisfactory as the manner in which the offer was made.

Finally, if a party asks a court to resolve a dispute about whether there was an effective acceptance, the court will look at any other relevant circumstances to help it determine what was reasonable. For example, if an offer was sent by fax, an acceptance sent by regular mail might still be reasonable if the mail service between the offeree and offeror was relatively quick and reliable, and no other factors indicated that the offeror needed a particularly quick response. Or if an offeree had technical difficulties in responding in the same way the offer was made--such as if the offeree's fax machine or e-mail system broke down--that could also be a factor in a court's decision as to whether an acceptance was reasonable. Of course, such difficulties would not help an attempted acceptance be considered reasonable where the offer had lapsed.

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality") contains further discussion of formality requirements many jurisdictions have for certain types of contracts.

2.10e An Acceptance May Be Effective at the Time of Dispatch or the Time of Receipt

Different jurisdictions have different rules about when an acceptance is effective--when it forms a contract. And even within one jurisdiction, there may be different rules about this subject in different situations. So as with the sale of goods exception for acceptances, it is essential to look at the particular contract law which applies to the parties and the transaction in question. These rules can be important because, as discussed above, the timing of an acceptance can affect whether the acceptance is proper or not, and whether a contract can be formed.

(1) Very Generally, in Many Common Law Jurisdictions, Acceptances Are Effective on Dispatch If They Are Sent Diligently and in a Reasonable Manner

Common law and civil law jurisdictions may have different rules about when acceptances are effective. In at least some civil law jurisdictions, the general rule is that acceptances are effective when they are received by the offeror ("effective on receipt"), unless the offeror specified otherwise in the offer. Other civil law jurisdictions appear to say, at least sometimes, that acceptances are generally effective when sent by the offeree ("effective on dispatch"). These civil law rules are further discussed in Section 2.12 of this Chapter.

Very generally, in many common law jurisdictions, if an acceptance is sent diligently and in a reasonable manner, it is effective on dispatch. If those requirements are not met, the acceptance is effective on receipt, provided it actually arrives in a way that is as fast, reliable, and otherwise satisfactory as an acceptance sent diligently and in a reasonable manner. This is often called the "mailbox rule," since it can mean that an offeree's acceptance is effective at the moment it enters the mailbox (or mail system). As with the rules regarding what is a reasonable manner of acceptance, there does not seem to be complete agreement among legal authorities about when each rule applies. So this Section will merely try to present general ideas in this area.

One way to think about the general rules about when acceptances are effective in common law jurisdictions is to consider two things:

(1) what the offer itself said about acceptance,

AND (2) what the offeree actually did to accept it.

The following illustration presents these two factors and their effect on when an acceptance is effective.



Illustration: When an Acceptance Is Effective (Many Common Law Jurisdictions)

What the offer SAID about acceptance:	**What the offeree DID to accept the offer:**	**WHEN that acceptance is effective:**
1. The offer stated a specific time when an acceptance would be effective.	The offeree makes a proper acceptance as the offeror requested.	**EFFECTIVE AT THE SPECIFIC TIME** the offer stated.
2. The offer required or suggested one specific manner of acceptance.	**a.** The offeree **diligently**: (1) accepts in **that manner**; or (2) (if the offer allows) accepts in a manner that is **generally similar or better**.	**EFFECTIVE ON DISPATCH** The offeree's acceptance is effective when sent.
	b. The offeree (**1**) **undiligently** uses the manner described, or (if allowed) one that is generally similar or better; **or** (**2**) uses a manner which is **not generally similar or better**--**provided** that the acceptance actually arrives in a way that is as fast, reliable, and otherwise satisfactory as if sent diligently in the manner described.	**EFFECTIVE ON RECEIPT** The offeree's acceptance is effective when the offeror receives it.
3. The offer did not describe any manner for acceptance.	**a.** The offeree **diligently** uses a manner that is **reasonable** under the circumstances, generally the same manner the offeror used, or one that is generally similar or better.	**EFFECTIVE ON DISPATCH**
	b. The offeree accepts in a manner that is **not reasonable**, which generally means (**1**) in a manner that is **not the same, generally similar or better**, **or** (**2**) **undiligently** by a manner that is the same, or generally similar or better--**provided** that the acceptance actually arrives in a way that is as fast, reliable and otherwise satisfactory as if sent diligently by a reasonable manner.	**EFFECTIVE ON RECEIPT**
4. The offer is held open by an option contract.	The offeree makes a proper acceptance of the offer which the option held open.	**EFFECTIVE ON RECEIPT** unless the option says otherwise.

*** ***WHY IS THIS IMPORTANT?*** Why do many common law jurisdictions apply the "effective on dispatch" rule explained above?

The effective on dispatch rule described above may be somewhat confusing, but it is an important part of the contract law of many jurisdictions.

One justification for the rule is the idea that an offeree really makes her acceptance at the point when that offeree voluntarily puts the acceptance outside of her own control in a reasonable manner, such as in the mail. Common law jurisdictions generally use this rule to stop the offeror from revoking--or the offer from terminating in some other way--once the offeree has reason to believe she has accepted. This protects the offeree, who might send the acceptance, rely on the contract in some substantial way (such as by not accepting other offers), then find the offer terminated later--after she thought acceptance occurred!

Of course, it is debatable whether the offeror should be bound by an acceptance she never received, simply because the offeree sent it in a reasonable and diligent manner. Some legal authorities say it is better to put the risk of a lost acceptance on the offeror in this situation. This is because the offeree is less likely to realize the acceptance is lost, but more likely to rely on a lost acceptance than the offeror is, because most offerors will not rely on a contract until they have actually received an acceptance. In fact, offerors are more likely to inquire if they never receive replies to their offers--and the common law idea is that it is better to put the risk of a lost acceptance on people who are less vulnerable to the risk! In addition, even though a contract is formed, it appears that courts may sometimes "discharge"--end--the duties of offerors to perform if those offerors never receive acceptances. Discharge of duties will be discussed more fully in Chapter 9 ("Performance and Discharge of Duties").

*** ***CASE STUDY 89*** **(Common Law)**

FACTS Khin Khun told an insurance agent that he wanted to buy a $100,000 fire insurance policy for his house. The Big Risk Insurance Company replied that it would insure Khun's house effective at the moment Khun accepted its offer. On January 2, the insurance agent wrote by regular mail to Khun to tell him about the terms--making Big Risk's offer to Khun--but Khun was away from home.

Khun did not see the letter until January 20. On January 21, Khun sent the agent his agreement to the insurance (properly addressed and by regular mail) along with a check to pay the insurance premium. Unfortunately, Khun's house burned down on January 23. The insurance agent received the letter and check on January 27.

On January 28, the agent wrote to Khun. The agent said that the Big Risk company refused to recognize any insurance contract because Khun's house had burned down on January 23--and the subject matter of the offer had been destroyed, thus terminating the offer before Khun made a proper acceptance. Khun sued the insurance company for the $100,000 proceeds of the insurance policy.

QUESTION OF LAW Did Khun's insurance contract start when he mailed the acceptance to Big Risk?

DECISION Yes. The acceptance by Khun, transmitted diligently by regular mail, was effective on dispatch and created a contract at that time.

In many common law jurisdictions, acceptances are effective on dispatch as long as they are sent diligently and in a reasonable manner. In this case, Big Risk did not describe any specific manner for Khun to accept its offer for a fire insurance policy--an offer which it sent by regular mail. Since the offer did not describe any particular manner for acceptance, Khun diligently accepted by a manner that was reasonable under the circumstances: regular mail, the same manner the offer used. Diligent acceptance by a reasonable manner = acceptance effective on dispatch.

In Case Study 89, suppose Khun accepted by an unreasonable manner--such as if he gave his acceptance to his 4-year-old child to hand deliver to Big Risk all the way across Phnom Penh. Or suppose that Khun was not diligent--such as if he put a completely wrong address on the envelope. In those situations, the acceptance would not have been effective until it was received. And it would only have been effective at all if received within the time it would have generally taken a reasonable acceptance to arrive. So if Khun had tried to accept in such an unreasonable or undiligent manner, the acceptance would probably not have been effective at the time Khun's house burned down--and there would probably have been no contract.

(2) The "Race" between Acceptances and Revocations

Offerees can accept offers, and offerors can revoke offers. In some cases, there is an acceptance by the offeree and a revocation by the offeror in the same transaction. As discussed in Section 2.4a of this Chapter, an offeror's revocation is effective only when the offeree receives the revocation. And as illustrated above, under different contract law rules an offeree's acceptance may be effective on dispatch by the offeree, or it may be effective on receipt by the offeror, depending on the situation.

Because of these rules, it is sometimes possible for an offeree's acceptance to run a "race" against the offeror's revocation! The chart below illustrates the possibility.



Illustration: Acceptances v. Revocations

IF the offeror sends a revocation of her offer...

BUT BEFORE the offeree receives that revocation,

either The offeree sends a proper acceptance which is EFFECTIVE ON DISPATCH

or The offeror receives a proper acceptance that is EFFECTIVE ON RECEIPT

THEN **THERE IS A CONTRACT!**
The offeree's acceptance "beat" the offeror's revocation, even though the offeror may have actually sent the revocation first. So the revocation has no effect.

(3) The "Race" between Acceptances and Rejections

Offerees can make both acceptances and rejections. In some cases, there is an acceptance and a rejection by the offeree in the same transaction. This might occur if the offeree decides to respond to an offer in one way, but later changes her mind. As discussed in Section 2.5a of this Chapter, an offeree's rejection is effective only when the offeror receives the rejection. And as explained above, under different contract law rules an offeree's acceptance may be effective on dispatch by the offeree, or it may be effective on receipt by the offeror, depending on the situation.

Because of these rules, it is sometimes possible for an offeree's acceptance to run a "race" against her own rejection! This is a difficult situation. In most situations (though not always), the "effective on receipt" rules appear to apply. That is, whichever communication the offeror receives first--the rejection or the acceptance--is usually effective. If the acceptance is received first, there is always a contract, and the rejection has no effect. If the rejection is received first, there is usually no enforceable contract (and the offer terminates) unless--at least in common law jurisdictions--certain requirements are met. The chart below explains these rules more specifically.



Illustration: Acceptances v. Rejections

If both an **acceptance and a rejection are sent** before either one is received by the offeror

AND....

The **ACCEPTANCE** arrives first...**THEN**

THERE IS A CONTRACT! The offeree's acceptance "beat" her own rejection, even though the offeree may have sent the rejection first! So the rejection has no effect.

BUT IF...

The **REJECTION** arrives first...**THEN**

(1) If the acceptance is normally **effective on receipt**, then **THERE IS NO CONTRACT!** (and the offer terminates)

(2) If the acceptance is normally **effective on dispatch**, then there are **two possibilities (in common law jurisdictions):**

(a) **Some common law courts: THERE IS A CONTRACT but** the offeree generally cannot enforce it if the offeror detrimentally relied on the rejection; **OR**

(b) **Other common law courts:** (1) **if the acceptance was sent first, there is a CONTRACT but** the offeree generally cannot enforce it if the offeror detrimentally relied on the rejection; **BUT** (2) **if the rejection was sent first**, there is **NO CONTRACT**.

The special common law rules above try to protect the offeror where she detrimentally relies on a rejection by the offeree before receiving the acceptance. For example, an offeror might make a binding contract with a different party, or spend money or time trying to make another contract, in reliance on a rejection from the offeree. These rules basically say that the offeree will not be able to enforce any resulting contract in that situation--even where the acceptance would normally have been effective on dispatch, before the rejection was received and before it was effective!

2.11 If It Is Not Clear Whether an Offeror Wants Only an Act or Only a Promise from the Offeree, Courts Generally Give the Offeree the Choice of Accepting by Performing the Act Requested or Promising to Do So

Sometimes it is really not clear whether an offer is requesting an act or a promise from the offeree--whether it is an offer for what common law jurisdictions would call a unilateral contract or a bilateral contract. This is a difficult but very important problem, because the offeree must know how to properly accept the offer.

If it is not clear whether an offeror wants an act or a promise from the offeree, common law courts will generally give the offeree the choice of accepting by performing the act or promising to do so. One effect of this rule is that such unclear offers actually give the offeree the opportunity to create a bilateral contract if she wishes. That can be a valuable option because of the added security of mutual promises that bilateral contracts often give.

In addition, some jurisdictions appear to say that even where the offeree decides to perform--and not make a promise--in response to the unclear offer, the start of performance actually forms a bilateral contract with the offeror! This provides even more protection for the offeree, though it also obligates the offeree to finish performance, which would not normally happen where the offeree accepts by performing the act requested.

Consider the following Case Study.

*** ***CASE STUDY 90***

FACTS Saray is a computer instructor. Saray's friend Im says to him: "Computer lessons for me, for ten weeks, three hours per week, $10 per week, starting at your house, Monday, 2:00 p.m." Saray says, "I accept your offer."

Im takes computer lessons from Saray for three weeks and learns a great deal. But at the end of the three weeks, Im has still not paid Saray any money for the lessons. So Saray says to Im: "Please pay me."

But Im says he has no contract obligation to pay Saray because there is no contract. Im claims his offer requested that Saray actually teach him about computers for the full ten weeks--not that Saray merely promise to do so. As a result, Im says, there is no contract yet--and he has no contract obligation to Saray.

QUESTION OF LAW Did Saray's statement that he accepted Im's offer create a contract?

DECISION Yes. Saray's promise that he would teach Im as described in Im's offer was a proper acceptance, and a contract was formed, because it was not clear whether Im's offer was requesting performance or a promise.

Common law courts generally say that, where it is not clear whether an offer requests that the offeree perform an act or make a promise, the offeree can choose either way to accept the offer. In this case, Saray's promise to teach Im about computers was a proper acceptance because Im's offer was not clear about whether it sought an act or a promise. Im said he wanted the computer lessons. But it was not really clear whether he wanted Saray to just give him the lessons (an act), or to promise to do so. Most courts say that in this situation, the offeree can accept by performance or a promise. So in this case, Saray had the opportunity to make a proper acceptance (and form

a contract with Im) simply by promising to do what was described in Im's offer. That is exactly what Saray did. So a contract was formed immediately which required Saray to teach and Im to pay for a full ten week computer course. Proper acceptance = contract.

And some courts would say that even if Saray had chosen to accept merely by performing, the start of his performance would have actually formed a bilateral contract. Of course, that would have obligated both parties to perform.

One last point to remember is that these rules can provide protection for both parties, including offerors like Im in Case Study 90. This is because the contract Saray formed when he promised to teach Im about computers also bound Saray to fully perform the contract. So if it had been Saray (instead of Im) who claimed there was no contract, or refused to perform, then Im would have been able to enforce the contract against Saray.

*** ***WHY IS THIS IMPORTANT?*** Why do courts apply these rules saying that offerees can accept offers that are not clear about whether they seek an act or a promise either by performing the act or making the promise?

Many jurisdictions want parties to have the opportunity to form bilateral contracts provided that would not violate the clear intentions of the offeror. Legal authorities believe that most contracts in the world today are bilateral, especially in business and government activity. One reason for this is that most offerors and offerees (except in certain special situations like public offers) want a commitment right away that the other party will in fact perform, and unilateral contracts do not provide such commitments. But bilateral contracts do.

Courts also generally prefer bilateral contracts when an offer is unclear about whether it seeks an act or a promise. In fact, as noted above, some courts say that an offeree who merely starts to perform in response to an unclear offer forms a bilateral contract. These courts say that starting performance in such an unclear situation can actually be an implied promise that the offeree will complete performance. It also appears that such courts will do whatever they can to protect the offeree in such unclear situations. For example, in Case Study 90, if Saray had merely started to teach Im about computers without making an express promise, some courts would still view that as an acceptance (implied promise) forming a bilateral contract. Of course, where it is very clear the offeror wants only a promise and not an act (like the tour director Sochua in Case Study 73), then the offeree will have more trouble showing an implied promise merely by starting performance. So it is usually safer for offerees to make a promise if they are not sure whether an offer seeks an act or a promise.

The main reason for courts' preference for giving parties the opportunity to form bilateral contracts is that the rules for bilateral contracts provide

immediate rights and protections for both parties. This is different from unilateral contracts. In the unilateral contract situation, the offeree generally has less protection until she has completed the specific act the offeror requested. And the unilateral contract offeror also has no commitment that the offeree will perform. In many cases, the offeror also wants the immediate commitment of the offeree to perform--and only bilateral contracts provide that.

Finally, some special commercial laws also prefer to give parties the opportunity to create bilateral contracts, particularly with respect to the sale of goods. For example, the Uniform Commercial Code in the United States says that if any offer for the sale of goods does not clearly specify that it requires only an act or only a promise for acceptance, then the offeree can accept the offer either by doing the act that the offeror ultimately wanted, or by promising to do that act.

Of course, parties do not always wish to make bilateral contracts. For example, most reward offerors and offerees probably do not wish to be bound by bilateral contract rules. In such cases, the offeror probably wants many people to try to perform the act she has requested--but not to make binding contracts with all of them, which could cause many disputes, especially if many persons claimed to have performed. And most offerees in such situations would not want to be committed to performing the act requested, where the act may be difficult and many other offerees may be trying to perform it at the same time. So courts will apply unilateral contract rules in cases where it is clear that is what the offeror wants.

2.12 Real Agreement in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the Cambodian legal tradition and the civil law tradition to real agreement appear generally compatible with the approach discussed in this Chapter. The approaches of these traditions to real agreement are discussed below.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) contains several provisions relevant to the discussion of real agreement in this Chapter. These provisions are briefly explained below.

Article 1 defines a contract as a "freewill agreement" between two or more persons to create or affect obligations relevant to those persons. Article 3 states that a contract is valid only if, among other things, it "arises out of a real and free agreement" and "has a subject matter that is certain." This requirement of certainty seems similar to the requirements discussed in this Chapter that valid offers be definite and reasonably clear, and that proper acceptances be unequivocal and unconditional. Article 6 states that a contract

will be deemed "voidable" if it does not result from a "real and free agreement," and Article 7 says that agreements resulting from mistake, duress or fraud are not real agreements.

These Decree provisions seem consistent with the ideas in this Chapter. However, the Decree does not appear to discuss "offer" or "acceptance" specifically.

*** ***CIVIL LAW PERSPECTIVE:*** The approach of the civil law tradition to real agreement seems generally compatible with that discussed in this Chapter. However, some civil law jurisdictions have different ideas about several of the important principles discussed in this Chapter.

First, many civil law jurisdictions appears to have a different view about when an offeror can revoke an offer. Specifically, many civil law jurisdictions appear to say that an offeror cannot revoke her offer whenever she wants before the offeree accepts. Such jurisdictions say that the offeror cannot revoke the offer for a reasonable time, as long as no expiration time is specified in the offer itself. For example, this appears to be the law in France and Germany. As the reader will recall, the common law rule discussed earlier in this Chapter is that the offeror generally can revoke her offer any time before acceptance, though there are certain exceptions.

Second, civil law jurisdictions do not appear to have a doctrine comparable to promissory estoppel. However, there may actually be less need for promissory estoppel in civil law jurisdictions. Since civil law jurisdictions do not require consideration in order for a contract to be enforceable, there is less need to find a doctrine to help courts enforce agreements where there is no consideration. In addition, as explained above, many civil law jurisdictions say an offer cannot generally be revoked for a reasonable time. In such jurisdictions, there may be less need for promissory estoppel to prevent the injustice that may occur where offerors try to revoke after offerees have justifiably relied on offers.

Third, many civil law jurisdictions appear to define bilateral and unilateral contracts differently from the way they are defined in common law jurisdictions. For example, in civil law jurisdictions like France, it appears that a bilateral contract is one with obligations on both sides, whereas a unilateral contract is one with obligations on only one side, such as an agreement to make a gift. Of course, this different idea about bilateral and unilateral contracts would affect to some degree the way that valid offers and proper acceptances could be made in such jurisdictions.

Fourth, some civil law jurisdictions appear to have different views about when an acceptance is effective. As described above, many common law jurisdictions say that acceptances are sometimes "effective on dispatch," but sometimes "effective on receipt." By contrast, some civil law jurisdictions say that acceptances are generally effective when they are received by the offeror.

For example, this appears to be the case in Germany. However, other civil law jurisdictions appear to say (at least sometimes) that acceptances are generally "effective on dispatch." For example, in France, there appear to be two different ideas about when acceptances are effective: some say the "effective on dispatch" rule ("*théorie de l'émission*") should generally apply, and others say the "effective on receipt" rule ("*théorie de la réception*") should generally apply. It appears that the "*théorie de l'émission*" may now be the prevailing rule in France. In any case, these different ideas show the importance of checking the specific law that applies to the transaction in question.

2.13 Questions for Review

CHAPTER 2 -- QUESTIONS FOR REVIEW

1. What is an offer?
2. What are three basic requirements of a valid offer?
3. When is an offer valid even though it is not seriously intended?
4. What terms must a valid sale of goods offer generally contain?
5. What is "chicken?" How does that relate to the rules in this text about the definiteness and clarity of offers?
6. When does an offer not have to be so definite? Give examples.
7. Who can accept an offer? Who cannot?
8. Name two things that may look like offers, but are not offers.
9. In general, are advertisements offers? Why?
10. How does bid solicitation work? Why is it important?
11. What are the three general ways offers can terminate?
12. When can an offeror revoke an offer, in general?
13. To whom must a revocation be communicated?
14. When is a mailed revocation effective?
15. What are the reasons for the above rule about when mailed revocations are effective?
16. What are the two ways in which an offeror can revoke? Explain each.

17. How can public offers be revoked?

18. Name four circumstances when an offeror may not be able to revoke in common law jurisdictions, even if there is no acceptance yet.

19. What do common law courts generally say about revocation where there has been part performance in response a unilateral contract offer?

20. What is a rejection? When is it effective?

21. What is the effect of a counter-offer?

22. What is the difference between a counter-offer and a rejection?

23. Compare the legal effects when offerees make inquiries, "grumbling acceptances," and acceptances.

24. What are five common ways that specific events outside the direct control of the offeror or offeree can terminate an offer?

25. How do courts determine what is a "reasonable time" for an offer to last when the offeror does not specify when it expires?

26. How can death or incompetence terminate an offer?

27. What is an acceptance?

28. What are two important general limits on how acceptances can occur?

29. In general, who can accept an offer?

30. What are two special situations where an offer can be accepted even though the offeror does not really want the accepting party to do so?

31. In general, how must offerees accept offers for unilateral contracts?

32. What is the most fundamental requirement the offeree must meet in order to properly accept an offer for a bilateral contract?

33. What are the four basic elements into which this text divides the fundamental requirement described in the previous question?

34. How can conduct communicate acceptance of an offer for a bilateral contract?

35. In general, is silence a proper acceptance of an offer for a bilateral contract?

36. What are four special situations where silence can be a proper acceptance of an offer for a bilateral contract?

37. What is required for an unequivocal and unconditional acceptance of an offer for a bilateral contract?

38. What is the "mirror image" rule?

39. How can an acceptance form a sale of goods contract even though the acceptance contains new or different terms?

40. If a contract is formed as described in Question 39, how do some courts determine whether the new or different terms become part of the contract?

41. Give examples of material and non-material changes to a sale of goods contract.

42. When is an offeree absolutely limited to just one manner of acceptance if she wants to make a bilateral contract?

43. How must an offeree accept an offer for a bilateral contract if the offeror does not insist on just one manner of acceptance?

44. When is an acceptance effective?

45. Explain how acceptances may "win races" against revocations and rejections.

46. How do many courts say an offeree may properly make an acceptance where the offer is not clear about whether it seeks an act or a promise?

47. Is the approach of the Cambodian legal tradition to real agreement basically compatible with the approach discussed in this Chapter?

48. Is the approach of the civil law tradition to real agreement basically compatible with the approach discussed in this Chapter? What are some important differences?

CHAPTER THREE

CONSIDERATION

3.1 Introduction

Consideration is one of the basic requirements for a valid contract in common law jurisdictions. Consideration is basically the "legal detriment" to each party to a contract, which means what each party does or agrees to do that he was not required to do before. Contracts that do not have consideration on both sides are generally not enforceable in court in common law jurisdictions. This was briefly explained in Chapter 1 ("Basic Aspects of Contract Law").

In this Chapter, Section 3.2 explains what consideration is in more detail. Section 3.3 lists the basic types of consideration. Consideration need not be equal or "reasonably proportioned" within a contract, but it must be legally sufficient, as explained in Section 3.4. Section 3.5 discusses some types of activities that are generally not consideration: pre-existing duties, legally unenforceable promises, past consideration, illusory promises, and love and affection. Part payment of a debt is generally not consideration, although there are exceptions, as explained in Section 3.6. Modifications of existing contracts generally require new consideration on each side, although again there are some exceptions to that rule, as discussed in Section 3.7. There are also some special situations in which many common law jurisdictions do not require consideration in order for a contract or promise to be enforceable. These include: promises to make charitable donations; new promises to pay debts discharged in bankruptcy; contracts made under seal; new promises to perform contracts that were unenforceable because of statutes of limitations or failure to meet writing requirements; firm offers for and modifications of sale of goods contracts; and promises that meet the requirements of promissory estoppel. Section 3.8 discusses these special situations.

The contract laws of many free market jurisdictions do not require consideration for a contract to be valid. Specifically, civil law jurisdictions do not have this requirement. And it does not appear explicitly in the current contract law of Cambodia. These differences will be explained in further detail in Section 3.9, below.

This Chapter contains a more complete discussion of consideration than Chapter 1 did. However, because only common law jurisdictions explicitly require consideration, this Chapter will explain it somewhat more briefly than other Chapters in this text explain their subjects.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4b contains a more concise discussion of consideration.

3.2 Basic Definition of Consideration: Exchange of Legal Detriment

As noted above, common law jurisdictions generally require consideration on both sides of a contract in order for that contract to be enforceable.

*** **DEFINITION: Consideration** is the new legal detriment to a party to a contract, which generally means what each party does or promises to do in exchange for a promise or performance from another party.

Usually the consideration in a contract is fairly obvious. When the consideration is not obvious, one way to understand it is to think of it as the **"legal detriment"** to each party to the contract--or what each party now must do that he did not have to do before. This could be paying money, plowing a field, or agreeing never to drink beer. Legal detriment does not mean a party must actually suffer "harm" in the usual sense--it means only that the party does or promises to do something that he was not previously required to do.

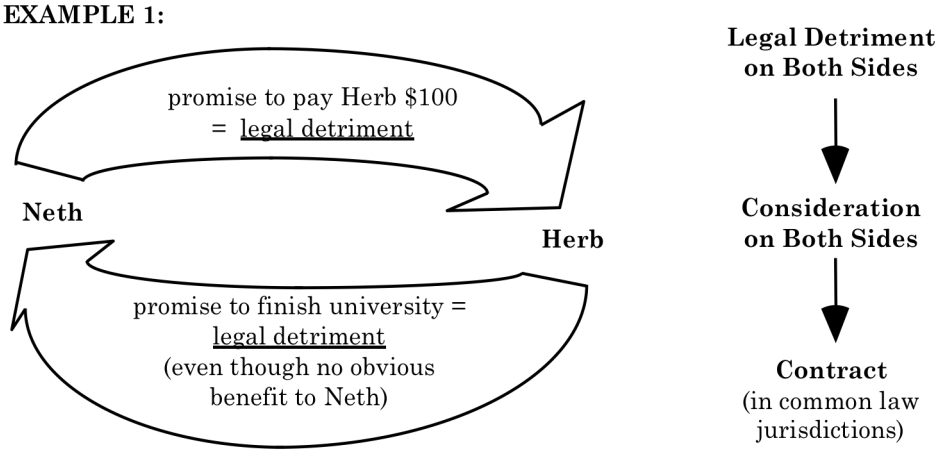
Consideration often directly benefits the other party to a contract, but in some cases it does not. For example, in a sale of goods contract, one party generally gives the other party goods, and the other party generally gives the first party money--so each party does get a benefit from the other party. But consideration can also be things such as a party's agreement to stop riding a bicycle, which would probably not directly benefit the promisee. So for consideration to exist, it does not matter whether there is any obvious benefit to the parties. The important thing for consideration to exist is that, before making the contract, neither party was required to perform the act he does or promises to do. But because of the contract, he now is required to perform that act. That is his "legal detriment."

So in order to see if there is consideration in any contract, simply ask the question: what is the legal detriment to each party? If there is legal detriment to each party, then there is consideration, and this common law requirement for a valid contract is met. But if there is no legal detriment to one (or more) of the parties, then there is no consideration, and this common law requirement is not met.

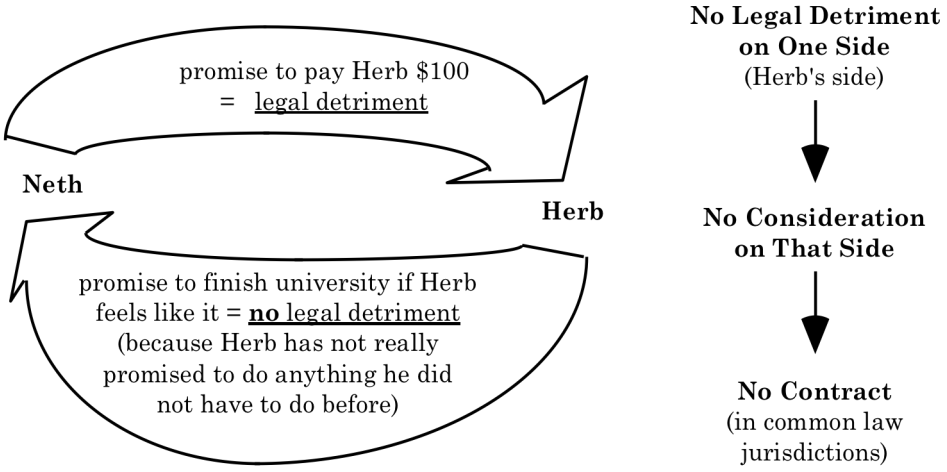
The following chart and Case Study illustrate this idea.

Illustration: How to See If There Is Consideration by Asking If There Is Legal Detriment to Each Party to a Potential Contract

EXAMPLE 1:



EXAMPLE 2:



*** ***CASE STUDY 91***

FACTS Dara is very thirsty. He goes to Sarun's shop and promises to give Sarun 2,000 riels for a bottle of beer. In return, Sarun promises to sell the beer to Dara for 2,000 riels.

QUESTION OF LAW Is there a binding contract between Dara and Sarun which can be enforced in a court?

DECISION Yes. Both parties, Dara and Sarun, have provided consideration, so this is a binding contract, assuming there are no other formation problems.

Common law jurisdictions generally require consideration for a contract to be enforceable. In this case, Dara promised to pay Sarun 2,000 riels in exchange for a bottle of beer. Dara's consideration (legal detriment) is his promise to give 2,000 riels to Sarun. Sarun's consideration (legal detriment) is his return promise to provide a bottle of Angkor beer to Dara. Before the contract, neither Dara nor Sarun had any obligation to do these things. But once the contract was formed, each party's promise (consideration) supported the promise (consideration) of the other party. So there was consideration in this case, and there appears to be a valid contract between Dara and Sarun.

Some authorities say that consideration must generally be a "bargained for exchange." This does not mean that the parties must actually bargain back and forth many times, as might occur at the market! It means only that the act or promise on each side of the contract must be given in exchange for the act or promise on the other side. So in order for consideration to exist, it must be bargained for and given in exchange for a promise, act or forbearance (a promise not to do something) by the other party. For example, in Case Study 91 above, suppose Sarun did not charge Dara any money at all, or gave Dara money for some reason other than an act or promise by Dara. In that situation, there would be no bargained for exchange, and no consideration. So no exchange of promises to do anything = no legal detriment = no consideration. In general, it appears that if the requirement of real agreement is met, then there is probably a bargained for exchange. Real agreement was discussed in detail in Chapter 2 ("Real Agreement (Offer and Acceptance)").

As long as there is a voluntary agreement between the parties, it does not usually matter why each party agrees to the bargain. For example, in Case Study 91, suppose Dara had entered Sarun's shop and placed a 500 riel note on the counter for a bottle of Angkor beer. If Sarun normally sold that beer to his customers for 2,000 riels, but he still agreed to hand over the bottle to Dara for 500 riels because he liked Dara, then there would still be a bargained for exchange. This is because there was still an exchange of voluntary promises to do something between the parties. This is true even though Sarun normally charged more money for the beer, and even though part of his reason for agreeing was simply that he liked Dara.

It is also important to note that certain specific kinds of promises do not require consideration in order to be enforceable in court, even in common law jurisdictions. Some of these exceptions will be explained later in this Chapter in Sections 3.6-3.8.

*** ***WHY IS THIS IMPORTANT?*** Why do common law jurisdictions generally require consideration for a contract to be enforceable?

Consideration is one tool common law jurisdictions use to distinguish between promises courts should enforce, and promises they should not enforce. The presence of consideration on both sides of an agreement usually shows that the parties were serious about their agreement--serious enough that they

both did or agreed to do something they did not have to do before. If one party does not meet this requirement, it suggests that the parties were not so serious, and probably did not wish to be legally bound. For example, this is considered to be the case with agreements to give gifts. Such agreements are generally considered to be "gratuitous" promises common law courts will not enforce.

Of course, consideration is a formal requirement, and formal requirements may not achieve justice in every situation. People do sometimes make serious promises without receiving anything in return. Therefore, as noted above, common law courts do not require consideration in every situation. Situations in which consideration may not be required will be discussed in some detail in Sections 3.6-3.8 below.

Although consideration is one way to measure whether the parties were serious enough about an agreement that the courts should enforce it, it is certainly debatable whether it is the best way! As noted earlier, many free market jurisdictions (notably civil law jurisdictions) do not use consideration as a tool to help them decide which contracts to enforce. This is further discussed in Section 3.9 below.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 1.4b contains further discussion of real agreement.

3.3 General Types of Consideration

As discussed to some extent above, consideration may exist in several different forms. In fact, there are at least three general types of consideration. These are:

(1) a promise to do something (such as Vannath's promise to give two dragon fruit to Sotia in return for his promise to pay her $1);

(2) a promise to forbear, which means a promise to refrain from doing something that a person would otherwise have the right to do (such as when a government official promises to refrain from suing a newspaper for defamation if he has a reasonable right to bring such a lawsuit); and

(3) an act other than a promise (such as Neam cleaning Saray's house in response to Saray's promise to pay Neam $1 if he does so).

3.4 The Amount of Consideration Need Not Be Equal or "Reasonably Proportioned," But It Must Be Legally Sufficient

Generally, the amount of consideration need not be equal on both sides, nor "reasonably proportioned," in order for a contract to be valid. That means that whether the bargain agreed upon by the parties seems "fair" is almost always irrelevant to whether there is consideration, and usually irrelevant to whether the contract is valid. In fact, courts often enforce contracts even though they may not seem completely fair because of an apparent difference in the value of the consideration on each side! Of course, very unequal consideration may indicate that there is some other formation problem, such as duress or undue influence. And extremely unequal consideration may be the result of an unconscionable agreement, as discussed briefly in Chapter 1 ("Basic Aspects of Contract Law"). But those are not consideration problems.

The consideration in a contract need only be "legally sufficient." This really means only that the consideration must be enough that it is not obviously worthless--such as a piece of dirt from the street, or one old, worn-out shoe with no sole. Consideration like that would appear to be only a "sham," perhaps to disguise a gift, and not a real contract with legal detriment on both sides. Only in cases like that might the consideration be "legally insufficient" to form an enforceable contract in common law jurisdictions. But in general, even consideration with a value as small as a peppercorn--a famous common law example--is legally sufficient.

*** ***CASE STUDY 92***

FACTS Vanna decides that she would like to buy a new moto, even though her old one still works fairly well. Vanna offers to sell her old moto to Narith for 10,000 riels. Narith is happy to buy Vanna's vehicle for this sum, and Narith accepts the offer.

QUESTION OF LAW Is Narith's consideration legally sufficient, and therefore good enough to form a valid contract?

DECISION Yes. The consideration here is legally sufficient, and the parties have a valid contract, assuming there is no other formation problem.

To exist, consideration only needs to be "legally sufficient" on each side--which is not necessarily the same as being economically valuable. All that is required is that the consideration constitutes some legal detriment. This detriment need not be large. And the value of the legal detriment to one party need not be equal to the value of the legal detriment to the other party.

In this case, both Vanna and Narith promised to do something--they exchanged promises for the purchase and sale of a moto. Of course, Vanna is not charging Narith very much money for the moto. And the value of the moto is probably not "equal" to the value of 10,000 riels. But the 10,000 riels Narith

agreed to pay still has some real legal value--it is not worthless. So it is legally sufficient, there is consideration, and the parties have a valid contract.

*** ***WHY IS THIS IMPORTANT?*** Why do common law jurisdictions not require consideration to be equal or "reasonably proportioned?"

Free market contract law generally wants parties to be able to make their own contracts, without interference from the courts or anyone else. This is part of the "freedom of contract." One reason for it is that, as discussed elsewhere, parties might refrain from making (or not bother to make) good contracts if they knew that courts might rewrite them. This could discourage economic activity. In addition, courts might be overwhelmed with parties asking to have their contracts rewritten, simply because the parties wanted a better deal, or no longer liked the deal they made. For these reasons, courts generally do not wish to interfere in the contracts the parties make just because one party complains that the consideration (the bargain) is not fair. So courts generally will neither rewrite contracts nor refuse to enforce them on this basis, unless the consideration really has no value at all.

Of course, it is important to remember that an agreement with unequal consideration may be the result of some other contract formation problem. It might have been caused by duress or undue influence. And agreements with extremely unequal consideration may actually be the result of unconscionability. In situations like that, courts may refuse to enforce the agreement for other reasons, as will be explained in more detail in Chapter 7 ("Other Contract Formation Problems"). But these other problems are different from a lack of consideration.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law") discusses some formation problems that may exist where an agreement is unfair; and Chapter 7 ("Other Contract Formation Problems") contains a more detailed explanation of some of those problems.

3.5 Acts or Promises That Are Generally Not Consideration

As discussed above in Section 3.4, consideration need not have great or even equal value to be legally sufficient. However, in some situations there is no consideration no matter how great a value a party's act or promise may seem to have! Specifically, consideration does not generally exist where it is actually:

(1) a pre-existing duty, which occurs where someone performs or promises to perform a duty he is already obligated to perform;

(2) a legally unenforceable promise, where someone promises not to do what he has no right to do;

(3) past consideration, which is an act done before the contract is made;

(4) an illusory promise, where one of the parties makes a promise which actually promises nothing, because it leaves to the promisor the choice of performance or non-performance;

OR (5) love and affection.

These five situations are discussed in the Sections below.

3.5a Pre-existing Duty

Sometimes a party to a potential contract does or promises to do something he is already legally obligated to do. An example would be a promise to perform duties under an existing contract. This is generally not consideration. The reason is that the person is not actually doing or promising to do anything new--anything that he was not required to do before. Instead, the person in such a situation is merely performing or promising to perform a "pre-existing duty."

*** ***CASE STUDY 93***

FACTS A builder named Leang examines Munthit's property, then makes a contract with Munthit to build a fence around Munthit's house. The parties agree that Munthit will pay Leang the sum of $75 for this work.

However, once Leang has examined the property more closely, he asks Munthit to give him an extra $20 because the job will be somewhat harder than Leang expected. Munthit agrees to this, fearing that Leang will not do the work at all if Munthit does not agree to pay the extra money.

QUESTION OF LAW Will a common law court enforce Munthit's promise to pay Leang the additional $20?

DECISION No. There is no consideration from Leang to support Munthit's promise to pay the extra $20, and so the promise is not enforceable.

Promises to perform pre-existing duties are generally not consideration. In this case, Munthit promised to pay Leang an additional $20, and this is additional consideration on his side. But Leang has promised to do no extra work, and so he has provided no extra consideration in return. In fact, Leang is already obligated to build the fence under the existing contract with Munthit. This is Leang's "pre-existing duty," for which Munthit has already agreed to pay $75. So there is no consideration from Leang for Munthit's promise to pay $20, and Munthit has no legal obligation to pay the $20.

However, in Case Study 93, suppose Leang had promised to paint the fence for $20, and Munthit had agreed to pay $20 for that service. Then there would have been new consideration on both sides. That is because Leang

would have agreed to some new detriment. But in the Case Study above, there was no such arrangement.

Some common law jurisdictions make exceptions to this general rule, in limited circumstances, in order to respect the real desires of the parties. Some of these exceptions are examined in Sections 3.6-3.8, below. Because of these potential exceptions, it is important to examine the law in the relevant jurisdiction in order to know what courts of that jurisdiction would do in this situation. But the general rule is that performing or promising to perform a pre-existing duty is not consideration.

3.5b Legally Unenforceable Promises

In some cases a party promises not to do something he has no legal right to do anyway, such as commit a crime. This is not consideration because courts will not enforce promises based on violating the law. The reason is that this is really like another kind of pre-existing duty--the duty of all citizens not to violate the law.

A promise to not commit a crime should not be confused with a promise to commit a crime. Promises to commit crimes are not enforceable because they lack legality, as explained in Chapter 5 ("Legality").

*** ***CASE STUDY 94***

FACTS Sophan tells widow Sok Cheng that if she promises to give him $250, then he will promise not to steal any of her property, or harm her or her family. Sok Cheng agrees because she is frightened of Sophan.

QUESTION OF LAW Is there consideration and an enforceable contract in this case?

DECISION No. There is no consideration and no contract because Sophan's promise was one not to commit a crime, which is something he has no right to do anyway.

A promise not to do something that a party has no right to do anyway, such as to commit an unlawful act, is not consideration. In this case, Sophan would be breaking the law if he did not keep his promise not to steal from Sok Cheng or harm her or her family. In fact, Sophan is already obligated by law to perform what he promised: not harm Sok Cheng or her family. So Sophan's promise is not consideration and it cannot be enforced. Of course, there may also be other reasons (such as duress) that there is no valid contract in this situation.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality") contains further discussion of the requirement of legality.

3.5c Past Consideration

Sometimes people promise to do something in exchange for an act that happened before the promise was made. This is not consideration, because the party making such a promise is not really promising to do anything new--to undertake any legal detriment--if the act is already in the past. Obviously, people cannot generally go back and perform acts in the past!

*** ***CASE STUDY 95***

FACTS Sola looked after her sick uncle for ten years. Then her uncle died. After her uncle's death, Sola's cousin Sokha (the uncle's son) promised to give Sola $500, in recognition of her past services to his father.

QUESTION OF LAW Is there a valid contract between Sola and Sokha in common law jurisdictions?

DECISION No. Sokha's promise to pay Sola after her care for her sick uncle has ended is not enforceable because it is based on past consideration.

Past consideration--such as an act carried out before a promise is made--is not consideration. In this case, there is no consideration to support the promise of Sola's cousin to pay Sola for her past care for her uncle. To be consideration, the cousin's promise to pay must induce Sola to do something new, something she was not required to do before. But of course, this is impossible if the promise to do the work is made after the work is already completed!

*** ***WHY IS THIS IMPORTANT?*** Why do common law jurisdictions say that past consideration is not consideration?

In some cases, this rule about past consideration may seem unfair. One example might be when someone does something significant for someone else--like taking care of a person while he is ill--but receives nothing in return. In that kind of situation, even if the person who received the benefit later promises to compensate the other person, this rule says the person who benefited has no contract obligation to keep his promise! And the rule may in fact be unfair in certain cases.

But the rationale for the rule appears to be that, if a party wants to be compensated for his efforts, that party should decide and make some arrangement for that at the start of his efforts. Otherwise, the efforts will be considered a gift. The law wants to encourage parties to be clear about whether they expect payment for their goods or services. This helps both parties understand what their relationship really is, and should avoid at least some disputes after that relationship has begun. In addition, the law simply cannot solve all problems, especially where complex emotional relations and moral debts are involved, as in Case Study 95.

Of course, it is also important to remember that this text is only discussing what agreements the law will enforce. The parties are generally free to make whatever gifts they want, or perform whatever lawful promises they like, without the involvement of the law or the courts. So in Case Study 95, there is nothing to prevent Sokha from giving the $500 to Sola if Sokha wishes to do so.

3.5d Illusory Promises

An "illusory" promise is one that appears to be a promise to do something, but in fact does not really commit the promisor to do anything. Illusory promises are generally not consideration.

*** ***CASE STUDY 96***

FACTS Sambo offers to sell the New Hotel as many brooms as the hotel might choose to order at 3,000 riels apiece. The hotel quickly accepts her offer.

QUESTION OF LAW Is there consideration (and an enforceable contract) in this situation?

DECISION No. The hotel's promise to buy brooms is an illusory promise, so there is no consideration on the hotel's side, and no enforceable contract.

Illusory promises are not consideration. In this case, where the hotel has promised to buy all the brooms it "might choose to order," there is no consideration because the hotel has not really committed itself to do anything. In fact, the hotel "might" order no brooms at all! If the hotel actually chose to order no brooms, it obviously would have no obligation to pay any money, or do anything else. So the hotel's promise to buy brooms is illusory, and it cannot be consideration. In this situation, there is no enforceable contract.

(1) Output and Requirements Contracts Can Often Be Enforced Even Though They May Seem Illusory

It is important to note, however, that there are two types of commercial sale of goods contracts that may seem illusory, but in many cases are not considered to be illusory by common law courts. These special kinds of commercial contracts are called output contracts and requirements contracts.

An output contract occurs where a seller of goods agrees to sell all of a certain kind of goods that that seller produces in a certain period to a specific buyer. A requirements contract is one where a buyer of goods agrees to buy all of a certain kind of goods that that buyer needs in a certain period from a specific seller. Of course, in these cases, it is possible that no goods at all will be produced by the seller or required by the buyer. So the promises seem illusory.

But courts will generally enforce these contracts anyway! Several reasons may exist for this. First, consideration does exist in these situations in the sense that the buyer or seller has agreed to some legal detriment. This is because he has agreed to give up the right to buy or sell the goods from or to anyone else. And in many cases, if the seller actually produced no goods at all, or the buyer bought no goods at all, they might endanger or even lose their businesses. For example, if a restaurant in Phnom Penh agrees to buy all its requirements for rice from a certain supplier for one year at a certain price, it is possible that the restaurant will require no rice. However, if that happens, the restaurant will probably go out of business! This is possible, but it is not considered a likely way for the restaurant to escape its obligation. In addition, in commercial contracts like this, the parties generally know each others' businesses fairly well. They know the risks involved. So common law courts generally say that such promises are not really illusory, and that there is consideration.

******* ***CASE STUDY 97***

FACTS The Enormous Construction Corporation needed a lot of iron for the many big new buildings it was planning to build in Phnom Penh over the next few years. So Enormous negotiated a contract with the Apsara Iron Corporation to get all the iron it would need. The parties signed a contract which said that Apsara would supply Enormous with all of the iron Enormous would need for its construction work in Cambodia for the next three years.

After the parties signed this contract, however, Apsara learned that the Even Construction Company would also need a lot of iron for its Cambodian construction contracts over the next few years. In fact, Apsara calculated that Even would need even more iron than Enormous would need. Apsara was very interested in supplying this iron! But Apsara did not have the capacity to supply both Enormous and Even.

Apsara decided it would prefer to have a contract with Even. So Apsara told Enormous that they actually had no enforceable contract together. Apsara claimed that Enormous' previous promise to buy all the iron it would require from Apsara was actually an illusory promise, because the promise did not really require Enormous to buy any iron at all from Apsara.

Now Enormous is asking the court to order Apsara to either honor the contract or provide a remedy.

QUESTION OF LAW Is there a valid contract between Apsara and Enormous?

DECISION Yes. The contract between Apsara and Enormous is a valid requirements contract even though it may seem illusory.

Parties can make valid contracts that require one party to sell another party all the goods of a certain kind that the other party will need during a certain time. These are requirements contracts. Such contracts are an exception to the general common law rule that contracts which do not necessarily obligate parties to do anything lack consideration.

In this case, there was a valid requirements contract in which Apsara agreed to sell Enormous all the iron Enormous would need over the next three years. Although it is possible that Enormous will require no iron, that is very unlikely in commercial contracts such as this. And in fact, Enormous has given up its right to buy iron from anyone else during the three year period in the contract. Therefore, consideration exists in this contract, and courts will enforce it. Apsara will have to honor the contract or provide a remedy to Enormous.

These output and requirements contracts may also seem too indefinite as to quantity, under the rules explained in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b. But such contracts are reasonably definite in the sense that the parties have said exactly the quantity they mean: whatever is actually produced or required! This is more specific than saying "whatever I might choose to sell" or "whatever I might choose to buy," as the New Hotel in Case Study 96 did. In addition, the parties are usually businesses that have calculated their needs and abilities, based on past situations. But despite this, sometimes such parties simply cannot say exactly how much they will produce or require in a given period, because of market conditions or other factors. These special contracts allow such parties the flexibility they need.

However, courts will generally not enforce these contracts where the amount produced or required turns out to be "unreasonably disproportionate" to any estimate the parties made, or if there is no estimate, disproportionate to any normal comparable quantity. In addition, many jurisdictions say that a duty of good faith and fair dealing is present in all contracts. This duty might require that parties to output and requirements contracts act honestly and reasonably in their performance. This duty was briefly discussed in Chapter 1 ("Basic Aspects of Contract Law"), and it will be explained in more detail in Chapter 8 ("Interpretation of Contracts"), Section 8.3j. So the parties do have some protection in these situations.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b discusses the requirement that offers (and contracts) be definite and reasonably clear; and Chapter 8 ("Interpretation of Contracts"), Section 8.3j explains the duty of good faith and fair dealing.

3.5e Love and Affection

Love and affection by themselves are generally not consideration. This is because they do not constitute legal detriment for which people typically bargain. For example, suppose a father promises a moto to his son because

he is a good son, and the son does nothing more than smile and promise to accept it. In that situation, there is no bargained for exchange and no legal detriment to the son--all he must do is accept a free moto! In fact, this is basically a gift, without any legal detriment on the son's side. This is true even though the son may actually feel some increased "love and affection" for his father because of the gift. Therefore, in common law jurisdictions, there is no consideration to make this kind of agreement enforceable.

In contrast, love and affection can be a motivation for a contract--so long as there is some legal detriment on each side of the contract. If the same father promised a moto to his son provided that the son graduated from the University of Phnom Penh, the contract would be supported by consideration. In this example, the son would be doing more than just accepting the moto. By going to university, the son is doing work and forgoing other possibilities in his life. That is a legal detriment. Another example would be if the same father agrees to sell the moto to his son for only one tenth of its market value. Although the son is getting a very good deal, there is still some legal detriment (and thus consideration) on both sides.

3.6 Part Payment of a Debt Is Generally Not Consideration

Sometimes a debtor pays or promises to pay only part of the debt he owes to another person under a contract. The general rule is that such a promise or partial payment of a debt is not consideration to support the creditor's promise to cancel the remainder of the debt. So paying or promising to pay only part of one's debt does not generally mean that one has provided consideration which will excuse one from paying the remainder--even if the creditor agrees!

The reason for this general rule is that the creditor is already entitled to the part payment--and to the rest of the amount due. The debtor's giving or promising to give something to which the creditor is already entitled is not new consideration. It is really just a pre-existing duty of the debtor.

*** ***CASE STUDY 98***

FACTS Several months ago, Channo borrowed $100 from his uncle. Channo has managed to repay $30 of the debt since then. But Channo is a student, and he is struggling to finish his studies and repay his uncle at the same time. In fact, Channo is thinking of leaving university before he is finished and taking a job, so he can repay his uncle more quickly.

But when Channo's uncle finds out that Channo may abandon his studies, the uncle is very worried. So the uncle goes to see his nephew and tells him that he will accept the $30 Channo has already paid as full payment of the debt. The uncle says that this means that Channo will not have to repay the remaining $70 to his uncle.

QUESTION OF LAW Is Channo still legally obligated to repay the remaining $70 to his uncle?

DECISION Yes. Under the general common law rule, Channo is still obligated to repay the remaining $70 he borrowed from his uncle.

The part payment of a debt is generally not consideration to support the creditor's promise to cancel the balance of the debt. In this case, Channo's uncle has made such a promise to Channo. This is not an enforceable promise. The reason is that Channo has no new legal detriment, despite his uncle's promise to accept the $30 Channo had already paid as full payment of the $100 debt. In fact, while the uncle promised something new--to accept only $30 instead of the full $100 Channo owed--Channo did not promise anything new. In fact, Channo has provided no new consideration. So in this case, Channo still owes his uncle $70.

3.6a Exceptions to the General Rule about Part Payment of a Debt

However, there are some exceptions to the general rule that part payment of a debt is not consideration to support the creditor's promise to cancel the rest of the debt. In some of these situations, there actually is some kind of legal detriment to each party, though there may not seem to be. But in other exceptions, it appears that there really is no new legal detriment to one of the parties. Instead, in these latter exceptions, the courts are trying to achieve some other important goal of public policy--despite the lack of any new legal detriment.

Specifically, many jurisdictions make exceptions to the general rule about part payment of a debt in situations where:

(1) there is a good faith dispute about the correct amount of the debt;

(2) the debtor promises a substitute performance;

(3) there is a composition of creditors who all agree to accept some portion of what the debtor owes them;

(4) the creditor cancels the written evidence of the debt; or

(5) the creditor provides a receipt in full and some indication that he is making a gift of the balance.

These exceptions are explained below.

(1) Good Faith Dispute -- If the amount of the debt is in dispute in good faith between the parties, the debt is canceled if the creditor accepts a lesser sum in full settlement of the debt. The basic idea behind this exception is that the law wants to encourage parties to resolve genuine disputes as quickly and easily as possible.

*** **DEFINITION: Good faith** is almost impossible to define exactly, but it generally includes a party's honest belief and conduct, and a lack of malice or intent to seek an unfair advantage.

In this situation involving a debt, "good faith" would basically mean that the parties have an honest difference of opinion about the correct amount of the debt. But if one party knows that the other party is correct about the amount of the debt, yet continues to claim otherwise, then there is no good faith dispute.

For example, in Case Study 98, suppose Channo and his uncle had a genuine, good faith dispute as to the amount of the debt. In that case, there would be consideration for the uncle's agreement to accept a sum less than he claimed was due as the final amount. The reason is that, in agreements like this, one party (the creditor) gives up the legitimate right to take his claim to court, and often accepts less money than he originally claimed. In return, the other party (the debtor) often gives new consideration, by promising to pay some amount he did not previously admit to owing. Of course, if either party agrees to settle the dispute on exactly the terms the other party wants, there does not appear to be any legal detriment to the party who is getting everything he wants! In that situation, it appears the settlement would generally still be enforceable despite the lack of consideration, presumably because the law simply wishes to promote the settlement of disputes.

This kind of settlement and payment may actually be a "substitute contract" or an "accord and satisfaction," at least in some common law jurisdictions. These are both types of later agreements of the parties which substitute a different duty for one owed under the original contract. They can actually result in the discharge of the prior contract duties. The basic difference between these two is that a substitute contract immediately discharges the duties owed in the contract it replaces, whereas an accord agreement merely suspends the prior duties until it has been performed (the satisfaction). Many jurisdictions say that where it is not clear which of these two types of agreements the parties have made, and the subject of the new agreement is a disputed debt, the court should assume the parties created a substitute contract. These ideas will be discussed in more detail in Chapter 9 ("Performance and Discharge of Duties"), 9.7c and 9.7d.

(2) Substitute Performance -- If a debtor promises a new, substitute performance that is different from the one already owed, and the creditor agrees to accept that performance in full satisfaction of the existing debt, there is consideration. In this case, there is new consideration on each side.

Of course, this kind of agreement would actually be a substitute contract or an accord and satisfaction. These two potential later agreements were just discussed with regard to good faith disputes. They are explained in more detail in Chapter 9 ("Performance and Discharge of Duties"), Sections 9.7c and 9.7d.

For example, suppose Saray still owes Phally $10 of a $20 debt. If Saray promises to drive Phally to Kompong Som instead of paying the last $10, and Phally agrees, there is consideration. This is because each party has actually agreed to do something new: Saray has agreed to provide a different performance, and Phally has agreed to accept that different performance instead of the old one. At least in theory, this is different from Phally's agreeing to accept only part of the old performance that Saray already owed. So in this case, if Saray performs by actually driving Phally to Kompong Som, he has fully performed the new agreement.

(3) Composition of Creditors -- Sometimes several different creditors are owed money by a debtor, and each creditor agrees to accept a percentage of the amount due in full settlement of the debt. This kind of agreement is known as a composition of creditors. It seems that such an agreement will cancel the additional unpaid balance due to these creditors, in some jurisdictions. It appears that there may actually be an agreement here among the creditors. So there may be a kind of consideration (legal detriment) on the part of each creditor to support the consideration of the other creditors, even though the debtor has apparently promised nothing new.

For example, suppose Vanna operates a coconut stall in the market. Vanna owes a total of $1000 to four different creditors, $250 to each creditor. So far Vanna has managed to repay a total of $600 ($150 to each creditor). However, Vanna knows that she cannot pay the remaining $400 and still stay in business. The four creditors are also aware of this fact. So the creditors meet and decide that if Vanna promises to repay 50% of the $400 she still owes--that is, $200, or $50 to each creditor--then they will accept that sum in full settlement of the amount due. This would be consideration, even though Vanna has not agreed to anything new.

(4) Written Evidence -- If the debt is documented by a note or other written evidence, cancellation by the creditor and return of the written evidence to the debtor cancels the debt. "Cancellation" in this situation means that the effect of the note or other written evidence is destroyed or made invalid. A note is basically a document containing a promise from the signer (the maker of the promise) to pay a specified person (the holder of the note) a definite sum of money at a specified time.

For example, suppose Sathya holds a note which contains a promise by her neighbor Sethik to pay Sathya $25 for a sewing machine she sold him before. Sethik still owes $20 of this debt. Last month, Sethik's wife helped Sathya in many ways when Sathya was ill, and couldn't feed her children or run her household properly. Sathya is grateful and wishes to cancel the remainder of the debt between Sethik and herself. So Sathya writes the word "canceled" on the note and returns it to Sethik. Now Sethik no longer owes Sathya any money for the sewing machine. Sathya has effectively canceled the debt.

This kind of cancellation of a debt is comparable to a release. A release is basically a document signed by a party in which that party discharges a duty owed to him. Releases will be discussed in more detail in Chapter 9 ("Performance and Discharge of Duties"), Section 9.7b.

(5) Receipt in Full and Indication of Gift -- If the debtor pays a smaller sum than is due, and then the creditor provides a receipt in full (such as a promise to "cancel the balance") and some indication that a gift is being made of the balance, the debt is canceled. This kind of document could also be similar to a release, as discussed above.

For example, suppose Nara owes his mother $18. So far, he has been able to repay only $12. But it will be the New Year soon, and Nara's mother decides that as a New Year's present Nara will not have to pay her the balance ($6). Therefore, Nara's mother sends him a receipt for the full amount and writes a letter explaining that he can consider the balance to be a gift to celebrate the New Year. In this situation, Nara no longer owes his mother any money.

As you can see, these exceptions to the general rule about part payment of a debt reduce the effect of the general rule a lot! But the general rule still applies in common law jurisdictions: in general, partial payment of a debt is not consideration for a creditor's promise to cancel the rest of the debt.

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties"), Section 9.7b contains further discussion of releases, Section 9.7c contains further discussion of substitute contracts, and Section 9.7d contains further discussion of accord and satisfaction.

3.7 Modifications of Existing Contracts Generally Require New Consideration on Each Side

When parties discuss changes to an existing contract, the general rule in most common law jurisdictions is that they are actually negotiating a new contract--which requires new consideration on both sides. The reason for this general rule is that, if there is no new consideration on each side, then not every party is actually agreeing to do something he did not have to do before! This would violate the pre-existing duty rule.

*** ***CASE STUDY 99***

FACTS Late one dark and stormy night, a moto driver named Samnang agrees to take Sapor to Wat Phnom for 1,000 riels. However, on the way to the Wat, while the moto is traveling through a deserted part of the city, Samnang politely asks Sapor if she would not mind paying 2,000 riels for the ride. Sapor agrees.

QUESTION OF LAW Is Sapor's promise to pay 2,000 riels for the moto ride enforceable in common law jurisdictions?

DECISION No. Sapor's promise to pay the extra money is a modification of an existing contract that lacks consideration on one side, and so it is probably not enforceable.

Most common law jurisdictions require new consideration for modifications of contracts. In this case, Sapor agreed to do something new--pay an extra 1,000 riels to Samnang for her moto ride. But Samnang did not agree to do anything new. In fact, his only obligation remained his original one: to take Sapor to Wat Phnom. So there is no new consideration on Samnang's side, and no enforceable change to the existing contract. Unenforceable change = contract remains at 1,000 riels.

This general requirement of new consideration reduces the possibility of unfair demands being placed on a party. In particular, courts look closely at agreements to modify existing contracts for indications of conduct which shows a lack of real agreement, such as duress. For example, one party might agree to make a larger payment for the same performance from the other side if the first party fears the other side will not perform otherwise. This occurred in Case Study 93, and perhaps Case Study 99, above. This is especially true in situations where the first party might have trouble getting anyone else to perform the contract, without great trouble or expense. Contract law does not wish to encourage such situations. So most common law courts will generally refuse to enforce the contract as modified.

However, it appears some common law jurisdictions no longer require consideration in order for parties to make enforceable modifications of contracts. These jurisdictions have decided they want to give parties more flexibility to make modified agreements than the rule explained above would give. In such jurisdictions, as long as modified agreements have no other formation problem--such as duress--it appears that new consideration is not required.

In addition, many jurisdictions do not require consideration for contract modifications in certain special situations. Some of these are discussed in Section 3.7a below.

3.7a Exceptions to the General Rule about Modifications of Existing Contracts

However, sometimes this general rule about "new consideration" might actually hinder the parties from making contract modifications of their own free will. Therefore, courts will make exceptions to the general rule in certain circumstances.

As with the exceptions relating to part payment of a debt, some of these exceptions are actually situations where consideration (legal detriment) exists but is hard to see. Others are situations where there really appears to be no consideration, but instead some other public policy goal motivates the law to make the exception. Of course, it is important to remember that these exceptions apply only if both parties are making the modification of their own free will.

Specifically, many jurisdictions say that modifications of contracts may not need to be supported by new consideration where:

(1) there is a mutual rescission;

(2) the parties encounter substantial and unforeseen difficulties; or

(3) there is a sale of goods contract, under certain commercial laws.

These exceptions are explained below.

(1) Mutual Rescission -- Some courts will find consideration in a modified agreement if they find that the parties have rescinded the original contract, so long as the original contract has not been fully performed on either side.

*** **DEFINITION: Mutual rescission** basically means the cancellation of a contract by agreement of the parties.

In this situation involving a modified agreement, to rescind the contract means that the parties freely agree together to cancel the original contract. A mutual rescission can be express, or implied, as might occur where the parties show through their actions that they do not intend to perform the contract.

Common law jurisdictions generally say mutual rescission is possible only where the contract is not fully executed on either side. The reason for that rule is that, if either party has fully performed, the other party has no new legal detriment--since he would have already received full performance. After a mutual rescission, the parties generally have no right to be paid under the contract. However, they generally still have the right to restitution, under the doctrine of quasi-contract. Rescission will be explained in more detail in Chapter 9 ("Performance and Discharge of Duties"), Section 9.7a, and Chapter 10 ("Remedies").

(2) Unforeseen and Substantial Difficulties -- Some courts will enforce a modified agreement which seems to have no new consideration if one party has unforeseen and substantial difficulties in performing the contract, and these difficulties cause an additional burden on the party's performance.

However, it appears that these difficulties must generally be so severe that the original contract duties could actually be discharged under the doctrines of impracticability or impossibility. Impracticability and

impossibility are fairly complex subjects. They will be discussed in much more detail in Chapter 9 ("Performance and Discharge of Duties"). In any event, there is new consideration in this situation--one party is refraining from asking the court to excuse him from performance, and in return the other party is giving some new consideration! But it is not usually enough that the performance merely turns out to be more difficult than the party thought it would be, as with the fence building contract in Case Study 93, above. An example of a difficulty that would be severe enough would be if the government, in Case Study 93, actually banned the construction of fences around houses.

(3) Sale of Goods -- Some jurisdictions also make an exception with respect to the sale of goods. The commercial laws of these jurisdictions say that new consideration is generally not required for a valid modification of a contract for the sale of goods, as long as the modification is made in good faith by both parties. An example is the Uniform Commercial Code in the United States.

In general, this exception helps buyers and sellers adjust quickly to the changing nature of commercial transactions in the business world. Such parties can modify sales contracts as they see fit, without worrying about consideration. For example, a buyer and seller might agree that the price the buyer must pay for some cigarettes should actually be lower than they previously agreed. The reason might be that the cigarettes became of a lower quality on the way to the buyer's address. In a situation like that, the laws of some jurisdictions wish to allow the parties the flexibility to modify their contracts freely, to reflect the realities of the modern business world.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 discusses quasi-contract in more detail; Chapter 9 ("Performance and Discharge of Duties"), Section 9.7a contains further discussion of mutual rescission, and Section 9.8a contains further discussion of impracticability; and Chapter 10 ("Remedies") contains further discussion of remedies such as rescission and restitution.

3.8 Situations Where Consideration May Not Be Required

Although common law jurisdictions generally require consideration in order for a contract or promise to be enforceable, such jurisdictions do not require consideration in certain limited situations. In these situations, the law has some special reason to enforce the contract or promise despite the lack of consideration. These special reasons include the promotion of trade or charitable giving, or even moral obligation.

This text will briefly discuss seven of the special situations where many common law jurisdictions do not require consideration. These situations are where there are:

(1) promises to make charitable contributions (voluntary subscription);

(2) new promises to pay debts discharged in bankruptcy;

(3) contracts under seal;

(4) new promises to fulfill contract obligations which are unenforceable because of statutes of limitation;

(5) new promises to fulfill contract obligations which are unenforceable because of failure to meet writing requirements;

(6) firm offers for and modifications of sale of goods contracts;

AND (7) promises that meet the requirements of promissory estoppel.

These exceptions are explained in the Sections below.

3.8a Promises to Make Charitable Donations (Voluntary Subscription)

Sometimes people make promises to donate money (called pledges) to institutions that work for the public good--without receiving any apparent consideration from the institutions in return for their promises. Examples of such institutions are religious, educational, cultural or aid organizations such as The Asia Foundation. Most common law courts will enforce pledges to such institutions, even though there is no obvious consideration given in return for the pledges.

Several explanations exist for this exception to the general rule requiring consideration. One is that there actually is consideration to support each contributor's promise: it is the promises of other contributors. This may be similar to one explanation for the "composition of creditors" exception to the general rule about part payment of a debt, as discussed in Section 3.6a above. In effect, this theory says that each contributor is actually making a contract with all the other contributors, instead of with the institution that actually receives the money! But it is not clear that such an "agreement" would meet the other requirements for a valid contract, such as real agreement. Another theory might be that the charitable organization, by accepting the pledge, is actually making an implied promise to continue its good work--which might be a form of "legal detriment." Another theory is that the promise to donate is actually an offer for a unilateral contract, which the charity accepts when it incurs liabilities or spends money. Still another theory is similar to promissory estoppel, and says that charitable organizations justifiably rely on such promises in making their plans and commitments. Perhaps the best

(or most honest) explanation is that charitable pledges do not require consideration simply because the law wishes to promote charitable giving.

*** ***CASE STUDY 100***

FACTS Sophornnara pledged 5,000 riels towards the building of Wat Thingy. Before Sophornnara actually gave the money to the charitable organization responsible for building the Wat, he went to take a look at the work in progress. But when he arrived at the building site, he was horrified to see that the Wat's architecture would not be classical Cambodian architecture. Instead, the new Wat would be futuristic! This was not Sophornnara's favorite style of architecture. Sophornnara regretted that he had not accepted the builders' invitation to see the construction site before he made his pledge.

Sophornnara decided that he would rather spend his 5,000 riels on a good meal than on this wat, and that he would not allow any of his money to be used for this project. He told the wat building organization that he would not fulfill his pledge.

Now the wat builders are asking the court to order Sophornnara to pay the amount he pledged.

QUESTION OF LAW Can Sophornnara avoid paying the 5,000 riels he pledged on the grounds that there was no consideration from the wat builders?

DECISION No. Sophornnara's pledge to the charitable organization responsible for building the wat created an enforceable obligation, and most courts would order Sophornnara to pay the 5,000 riels he promised.

Charitable contributions are an exception to the general common law rule requiring consideration in order for promises to be enforceable. So even though the charitable organization in this case did not explicitly promise Sophornnara that it would do anything, and even though there is no obvious consideration on the organization's side, Sophornnara's promise to the organization is still enforceable. He has a legal duty to pay 5,000 riels for the construction of the new wat.

3.8b New Promises to Pay Debts Discharged in Bankruptcy

The laws of some jurisdictions say that a debt discharged (or ended) after a court declares a person bankrupt can be renewed--that is, made enforceable again--by the debtor, even though there is no new consideration to support the debtor's promise.

In bankruptcy proceedings, courts often say that a bankrupt debtor does not have to pay some or even all of his debts. Courts do this in order to resolve the debtor's obligations and give him a chance to make a new financial start. However, under this exception to the general rule about consideration,

a bankrupt debtor's new promise to repay a debt can become enforceable against the debtor again--even though the bankruptcy court has already released the debtor from the obligation, and there is no new consideration. In many jurisdictions, this kind of obligation becomes enforceable again only where the debtor voluntarily agrees to pay the debt and the court approves.

3.8c Contracts under Seal

Contracts made under seal traditionally did not require consideration in order to be enforceable. It appears that contracts under seal are no longer used frequently in many common law jurisdictions. But they were used more frequently before the doctrine of consideration developed. It appears that a sealed writing required no consideration because the seal indicated by itself that the parties were serious about making an enforceable contract together.

Some jurisdictions have abolished the distinction between sealed (formal) and unsealed (simple) contracts completely, or at least done so with respect to certain kinds of contracts. For example, as noted in Chapter 1, ("Basic Aspects of Contract Law"), Section 1.3d, the Uniform Commercial Code in the United States has abolished this distinction as to the sale of goods.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3d contains further discussion of formal and simple contracts.

3.8d New Promises to Perform under Contracts Unenforceable Because of Statutes of Limitation

Sometimes people promise to pay a debt which, before the promise was made, could no longer be enforced because the relevant statute of limitations had expired. Such new promises to pay old debts do not require consideration in order to be enforceable.

*** **DEFINITION: Statutes of limitation** are laws which specify how much time a party has to make a certain kind of legal claim in court after the claim arises.

In general, these statutes are designed to promote finality in the law and in people's lives, and to force parties to make their legal claims while evidence is still useful. For example, under such a statute, parties may have a certain number of years to bring a claim for breach of contract. After that time passes, courts in that jurisdiction will generally not enforce that contract obligation even if it was valid before, because the time specified in the statute of limitations has passed.

However, if a debtor makes a new promise (express or implied) to the creditor to pay all or part of such a debt--after the statute of limitations has expired--no consideration is needed to make the new promise enforceable. Some jurisdictions require that the new promise be in writing. Other jurisdictions say that a promise to repay the debt may be implied merely

from the fact that the debtor makes a partial payment after the statute of limitations has expired, unless the debtor actually states that he is not promising to pay the rest of the debt!

*** ***CASE STUDY 101***

FACTS Samen and Sorit live in a jurisdiction where the statute of limitations for breach of contract actions is five years. Samen and Sorit make a valid contract for the sale of a new generator. Sorit delivers the generator soon after the time the contract is made, but Samen does not pay for it! Sorit asks for the money several times, but soon he becomes so busy with work that he forgets completely about the money.

One day six years later, Sorit sees Samen on the street and asks Samen for the money. At first, Samen refuses to pay, arguing that she no longer has any legal obligation to do so. But after speaking with a good friend about the matter, Samen decides she should pay for the generator after all. So she gives Sorit a signed document stating that she will in fact pay the full price of the generator within the next month.

QUESTION OF LAW Is Samen's new promise to pay for the generator enforceable?

DECISION Yes. Samen's new promise to pay Sorit for the generator is enforceable, because new promises to perform under contracts unenforceable because of statutes of limitation do not require new consideration.

In many jurisdictions, no consideration is required to support promises to perform under contracts that would otherwise be unenforceable because the statutes of limitation have expired. In this case, Sorit could no longer enforce Samen's obligation to pay for the generator she bought from him under the original contract after the five year statute of limitations had expired. However, Samen's new promise to pay for the generator revived her old legal obligation to pay for it--even though there was no new consideration! So Samen's new promise is enforceable.

3.8e New Promises to Perform under Contracts Unenforceable Because of Failure to Meet Writing Requirements

New promises to meet obligations which, before the promises were made, could no longer be enforced because of failure to meet writing requirements do not require consideration in order to be enforceable.

The laws of many jurisdictions say that certain kinds of contracts must be in writing in order to be enforceable. One common example is contracts for the sale of land. The general rule is that contracts which do not meet such writing requirements cannot be enforced, although there are limits on that general rule. This was briefly explained in Chapter 1 ("Basic Aspects

of Contract Law"), Section 1.4e, and will be discussed more fully in Chapter 6 ("Formality").

In any case, sometimes a party who has failed to meet a writing requirement later signs a memorandum or note which is sufficient to meet the writing requirement. In that situation, the new promise becomes enforceable, even though there is no new consideration.

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality") contains a more complete discussion of writing requirements.

3.8f Firm Offers for and Modifications of Sale of Goods Contracts

Commercial laws in some jurisdictions make exceptions to the general rule requiring consideration with respect to certain situations related to sale of goods contracts. An example is the Uniform Commercial Code in the United States. Two of these exceptions are discussed below.

The first exception is that many jurisdictions say that firm offers do not require consideration in order to remain open for a reasonable time, even if the offeror wants to revoke before the end of that time. "Firm" or "irrevocable" offers for the sale of goods occur where the offeror signs a written offer containing a statement that the offer is "irrevocable," or that it "will be held open," or other similar language. The promises made in such firm offers really operate like option contracts--except that, unlike option contracts, no consideration is required for these offers to remain open! These kinds of offers were discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4c.

The second exception is that a valid modification of a contract for the sale of goods does not require new consideration, as long as the modification is made in good faith by both parties. This exception as to the sale of goods is discussed in more detail in Section 3.7a, above.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4c contains further discussion of firm or irrevocable offers for the sale of goods.

3.8g Promises that Meet the Requirements of Promissory Estoppel

The doctrine of promissory estoppel basically says that if one person makes a promise to another person, and that other person justifiably relies on the promise, the promise may be enforced to the extent necessary to avoid injustice--even if there is no consideration! So if a promise meets the difficult requirements of promissory estoppel, then no consideration is required to make the promise enforceable by in court. This was already discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, and is explained in more detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, and Chapter 7 ("Other Contract Formation Problems"), Section 7.8 contain more complete discussions of promissory estoppel.

3.9 Consideration in the Cambodian Legal Tradition and the Civil Law Tradition

Current Cambodian contract law and the civil law tradition do not require consideration in order for a contract to be valid. This Section will briefly describe this important difference between these legal traditions and the common law tradition.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia, Decree #38D (1988), does not require consideration in order for a contract to be valid. Cambodia's formal legal tradition has been influenced by the civil law tradition, particularly French law, and this appears to be reflected in its current law with regard to consideration. One potential result of the lack of a requirement of consideration under Cambodian law is that promises to make gifts could be enforceable.

Several articles in the Cambodian contract law do seem relevant to common law ideas about the role of consideration in contracts. These provisions are briefly examined below.

First, Article 3 of Decree #38D states that:

"Every contract is valid provided that it:

- arises out of a real and free agreement;
- is made by parties who have capacity to enter into a contract;
- has a subject matter that is certain, possible to perform, lawful and consistent with public order and good custom."

So Article 3 does not require consideration for a contract to be valid. Instead, it requires a real and free agreement, and also requires some of the other basic elements of a valid contract which this text has discussed.

However, Article 12 of Decree #38D does at least seem to acknowledge the idea of consideration. In fact, Article 12 appears to suggest that if the value of what each party gives in a contract is not equal, then the aggrieved party can sue to rescind (cancel) the contract. Article 12 states:

"When making a contract, if there is a difference between the agreed value of the subject matter and the value of the consideration in return, then the aggrieved party can sue to rescind the contract on the ground that he never intended the difference to be a gift."

This provision appears to allow parties to ask a court to rescind a contract on the grounds that there is a "difference" in the values of the consideration (i.e. a "bad deal"). The provision might be used to protect parties from contract formation problems such as fraud or duress, which certainly might result in "unequal" consideration. However, the provision would also arguably allow the rescission of contracts which are considered to be unfair--even slightly unfair.

If this latter situation occurred, it would be different from contract law in most free market jurisdictions. Free market courts generally will not intervene in this way with regard to contracts the parties made of their own free will, except in very limited cases where the agreement is considered so extremely unfair that a doctrine like unconscionability would apply. It seems likely that many if not most contracts arguably have some "difference" between the values of the consideration. Article 12 would appear to be designed to protect weaker parties from contracts that do not favor them, which is certainly a positive general goal. In practice, it might not always be the weaker party to a contract who would benefit from the court's protection under Article 12. In addition, as explained above, some parties might be reluctant to invest in a jurisdiction if they thought that they could not generally rely on their contracts, or that contracts might be canceled to benefit a particular party. This could have a negative effect on economic development.

Another relevant provision of Decree #38D is Article 5. Article 5 says contracts are void if they are not consistent with, among other things, "social interests" or "principles of social ethics." (Of course, Article 3 provided that such agreements are not valid.) It is not exactly clear what these phrases mean. As with Article 12, they state worthy general goals. A party could arguably use Article 5 to try to avoid a contract on the basis of unequal consideration. For example, a party might argue that it is against "social ethics" for a certain company to get a good deal, for a tenant to pay a very low rent, or for rice to cost so much. Article 5 raises some of the issues that are discussed above as to Article 12.

*** ***CIVIL LAW PERSPECTIVE:*** As noted above, civil law jurisdictions do not require consideration in order for a contract to be valid. In fact, such jurisdictions generally enforce agreements without regard to whether there is any "consideration" or "legal detriment" on all sides of the agreement. So promises to make gifts may be enforceable in civil law jurisdictions.

The approaches of the civil law tradition and the common law tradition to substantive contract law are generally compatible. The lack of a consideration requirement in the civil law tradition may be the single most significant difference between the civil law approach and the common law approach to contract law.

3.10 Questions for Review

CHAPTER 3 -- QUESTIONS FOR REVIEW

1. Define consideration.

2. What is "legal detriment?"

3. Why do common law jurisdictions generally require consideration in order for a contract to be valid?

4. Must consideration be equal or "reasonably proportioned" on each side of a contract?

5. Name and explain five types of activities that are not generally consideration.

6. Explain what output contracts and requirements contracts are.

7. Is partial payment of a debt generally consideration for the creditor's promise to cancel the remainder of the debt?

8. What are some exceptions to the general rule above about partial payment of a debt?

9. Do modifications of existing contracts generally require new consideration?

10. What are some exceptions to the general rule above about modification of existing contracts?

11. Name and explain seven types of contracts or promises that do not require consideration to be enforceable, in many common law jurisdictions.

12. Does current Cambodian contract law require consideration in order for a valid contract to exist? What does it require?

13. Does the civil law tradition require consideration in order for a valid contract to exist?

14. Do you think it is a good idea to require consideration in order for a valid contract to exist?

CHAPTER FOUR

CAPACITY

4.1 Introduction

A person's real agreement is required in order for a contract to be valid in free market jurisdictions, as explained in Chapter 2 ("Real Agreement (Offer and Acceptance)"). Of course, each party to the contract must also have the basic "ability" to actually make the real agreement that is required. A person's ability--or legal competence--to make a contract is called her capacity to make that contract.

*** **DEFINITION:** **Capacity** is a person's legal power or qualification to do what adult persons generally have the legal power or qualification to do.

In general, a living adult person has contractual capacity--and thus the ability to make a valid contract--if she is able to understand the nature of making the contract, can control her actions in making the contract, and is permitted by law to make the contract. A person who lacks any of these qualities with regard to a particular agreement has some "incapacity." She generally cannot make a valid contract with regard to that agreement, and she generally can avoid any such agreement she does make.

The law also makes distinctions among persons who lack full capacity: some have total incapacity, and others have only partial incapacity. In many jurisdictions, if a person completely lacks capacity, contracts she makes are void. If a person only partially lacks capacity, then contracts she makes are generally voidable. The specific rules about the status of such contracts are discussed more fully in the Sections below.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4c contains a more concise discussion of the formation requirement of capacity; and Chapter 2 ("Real Agreement (Offer and Acceptance)") contains further discussion of real agreement.

4.2 Living Adults Generally Have Full Capacity to Make Contracts

The general rule is that living adults have the capacity to make valid contracts, with certain limits that will be explained in this Chapter. So if adult parties come to the court with a contract dispute, the court will generally presume that the parties have the capacity to contract. If a party lacks full capacity because she is in one of the special groups listed in Section 4.3 below, then that party must show this to the court if she wishes to avoid the contract.

Both "natural persons" and "legal entities" generally have the legal capacity to make contracts. A "natural person" is a human being. A "legal entity" is an entity other than a human being that has its own legal existence, and that can therefore make contracts in its own right. For example, governments, corporations and partnerships are such legal entities. Normally they have the capacity to make valid contracts. Sometimes such entities are referred to as "legal persons." So in law there are actually two types of "persons:" "legal persons" and "natural persons!" Both types of persons generally have the capacity to make valid contracts.

One general limit on who has the capacity to make contracts is that only natural persons who are alive at the time an agreement is made can form a contract. It may seem obvious that a dead offeree cannot accept an offer. But it is possible that an offeree could die after sending her acceptance but before her acceptance becomes effective. And of course, an offeror could die before her offer is accepted. In these situations, the offer is terminated at the time of death, and no contract can be formed. This was explained in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6c. Where a party dies after a contract is formed, the question is whether contract duties may be discharged, probably under doctrines of impossibility or impracticability. That problem is discussed in Chapter 9 ("Performance and Discharge of Duties"), Section 9.8a.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6c discusses how offers terminate when a party dies; and Chapter 9 ("Performance and Discharge of Duties"), Section 9.8a discusses how courts respond when a party dies after a contract is formed.

4.3 Persons Who May Not Have Full Capacity to Make Contracts

Capacity is basically the legal ability of a person to consent to a contract, as noted in Section 4.1. Most adults have the full capacity required to make a valid contract, as discussed in Section 4.2. But there are certain types of persons the contract laws of many free market jurisdictions generally say are unable to give the consent required to form such a valid contract. These persons have a total or partial incapacity to contract.

Specifically, the laws of many free market jurisdictions say that the following types of persons generally have incapacity to some degree:

(1) minors (as explained in Section 4.4);

(2) mentally incompetent persons (Section 4.5);

(3) intoxicated persons (Section 4.6);

(4) persons convicted of and imprisoned for serious crimes (Section 4.7); and

(5) foreigners, but only in very limited situations (Section 4.8).

This Chapter will discuss each of these special groups of persons--and describe the extent of their incapacity to contract--in the Sections that follow.

4.4 Contracts Minors Make Are Generally Voidable

In many jurisdictions, natural persons generally gain full capacity to contract when they reach the age of eighteen (18) years. In such jurisdictions, anyone below the age of eighteen years is called a "minor." Minors generally lack full capacity to contract. Of course, this rule applies only to natural persons--legal entities need not be any special age in order to have capacity to contract!

Because minors lack full capacity, the law protects them from the consequences of making contracts. Specifically, the law says that contracts minors make are generally voidable, with certain limits which are described below. This means that a minor may generally avoid such contracts.

A minor may still make contracts freely, and unless the minor chooses to avoid them, these contracts can be enforced. The minor can go to court and force the adult to abide by the contract. However, the adult cannot force the minor to obey the contract if the minor properly indicates that she will avoid it--even if the contract has been partly or fully performed. But if a minor wishes to perform a contract made with an adult, the adult is bound by it. The adult cannot avoid it just because the minor might avoid it!

*** ***WHY IS THIS IMPORTANT?*** Why does the law say that contracts minors make are generally voidable, and that the minor can avoid them if she wishes?

The reason for this rule is that most jurisdictions believe minors are likely to lack mature judgement. Because of this, such jurisdictions feel minors may be vulnerable to the actions of unscrupulous persons, who may take advantage of them in the marketplace. Even if no unscrupulous persons are involved, minors are believed to need protection from a tendency to buy without thinking carefully. And they may not be able to understand fully the consequences of making contracts. So the law says that contracts generally

cannot be enforced against minors if the minors do not wish to proceed with the contracts, with certain limited exceptions to be discussed below.

This general rule is also intended to discourage adults from dealing with minors in most circumstances. In some cases, the rule may actually seem unfair to adults, because a clever minor may be able to take advantage of an adult! But this possibility appears to further the general goal of the rule--to deter adults from making contracts with minors--by making such contracts risky for adults.

Although the basic purpose of these rules is to protect vulnerable minors from unscrupulous adults, the law in practice makes no distinction between contracts made with "scrupulous adults" and contracts made with "unscrupulous adults." In either case, the minor alone decides whether the voidable contract will be enforced. In addition, the law does not distinguish between "sophisticated minors" and "unsophisticated minors"--either kind can generally avoid contracts. So it is usually irrelevant with whom the minor deals, what kind of person the minor is, or what the circumstances of the contract are. An exception might be where both parties to the contract are minors, or lack capacity for some other reason. In that case, it would appear that neither party should be able to enforce the contract against the other.

*** ***CASE STUDY 102***

FACTS Chuon lived in a society where the age of majority was 18. When Chuon was 17 years old, he decided to buy a video cassette recorder that he saw on sale in Vantha's Video Shop. It was a $250 VCR, but for one day only Vantha was offering it for sale at the extra low price of only $99.95.

However, after Chuon brought the VCR home, he decided that he no longer wanted the VCR, because the purchase had left him with no more money. So he tried to avoid the contract.

QUESTION OF LAW Can Chuon avoid the contract, even though there was nothing unscrupulous about Vantha's conduct in selling the VCR to him?

DECISION Yes. Because Chuon is under 18 years old, he can avoid the contract on the grounds of lack of capacity, return the VCR and get his money back.

In general, the law gives minors the right to avoid contracts even where the other party is not at fault, and regardless of the minor's reason for wanting to avoid the contract. In this case, Chuon can avoid the VCR contract because he was only 17 years old (a minor) when he made the contract. By contrast, if Vantha wished to avoid the contract but Chuon did not, Vantha could not do so. This is because the contract is binding on Vantha if Chuon wants it to be. So if Chuon wanted to keep the VCR, Vantha could not get the VCR back, even if she returned the money Chuon paid.

In general, minors may "disaffirm" or "ratify" contracts they make. To disaffirm is to properly indicate that a person will avoid the contract. To ratify is to properly confirm that a person intends to be bound by the contract. These ideas will be discussed in the next two Sections.

4.4a Minors May Disaffirm Voidable Contracts They Make

As noted above, minors can avoid any voidable contract they make. When minors seek to avoid contracts, they "disaffirm" their contracts.

*** **DEFINITION: Disaffirmance** is one party's repudiation of or refusal to abide by a contract--that is, the party's proper indication that she will avoid the contract.

A minor can disaffirm a voidable contract at any time during her minority, or within a reasonable time after she reaches the age of majority. What is a "reasonable time" depends on all the circumstances of a particular case. For example, a minor might receive a lot more time to disaffirm a contract for the sale of an expensive item like a car than she would for a relatively minor item like a pen. It appears that many common law jurisdictions generally give minors a substantial amount of time--even years in some cases--to disaffirm voidable contracts. However, some authorities say this time may be shorter if the minor has received benefits under the contract both before and after she reached the age of majority.

It is also important to note that a minor cannot disaffirm only part of a contract and seek to go through with the rest. In other words, a minor cannot choose to disaffirm only what she does not like! A contract can only be disaffirmed totally, or not disaffirmed at all.

There are also some important differences related to disaffirmance based on whether a contract is executory or executed. First, if a contract made by a minor is completely executory (the contract has not yet been performed at all), a disaffirmance by the minor basically cancels the contract. This is basically a unilateral rescission of the contract. That means that no one--neither the minor nor the adult--is required to comply with the contract.

Second, if the contract is partly or fully executed (performed), then a disaffirmance means that the contract has no legal effect from the time of the disaffirmance. Again, this is basically a rescission. After a minor disaffirms a contract, she is no longer bound by the terms of the contract. She can also demand restitution (under quasi-contract) of whatever she has given to the other party under the contract. In addition, the minor may be required to return some or all of what she has received from the other party under the contract. This potential obligation is also based on quasi-contract.

Third, silence by the minor for a reasonable time after the minor reaches the age of majority has different effects on executory and executed

contracts. If a minor makes a contract that is still executory at the time the minor reaches the age of majority, and the minor is silent up to and for a reasonable time after reaching the age of majority, the law says that such silence automatically disaffirms the contract. But if the contract is already executed at the time the minor reaches the age of majority, and the minor is silent up to and for a reasonable time after reaching that age, then such silence automatically ratifies the contract--confirming that the minor will perform the contract. And in either case--disaffirmance or ratification--these are the effects of such silence whether the minor actually intends them or not.

In order to disaffirm, a minor need only indicate to the other party expressly or impliedly that she is disaffirming the contract--that she does not intend to be bound by it. From that time on, the contract is disaffirmed. The minor need not go to court to disaffirm. If the adult party asks a court to force the minor to comply with her obligations under the contract, the minor need merely prove to the court that she was a minor at the time the contract was made. That would be a valid defense to the adult's claim, because the law generally presumes that minors lack full capacity to contract.

As noted above, when a contract is disaffirmed in this way, the law generally tries to provide restitution to the parties, under the doctrine of quasi-contract--except that the adult may not be able to recover for benefits that the minor no longer has or cannot return. When a minor disaffirms a contract, she can recover whatever she has given to the other party under the contract. But the minor must return to the other party what the minor has received under the contract only if such items are still in her possession. That is, most jurisdictions say that the minor need not compensate the other party for items the minor no longer possesses or cannot return. If the minor no longer has some or all of the property, or has received services that cannot be returned, the minor may still disaffirm the contract. In that situation the other party still has to return all of what she has received from the minor, even though that party may not be able to recover all of what she has given to the minor.

So a minor can generally disaffirm a contract--and get back what she has given under the contract--even though the adult party may be damaged by the disaffirmance! This may seem unfair. But as discussed in Section 4.4 above, the "minor incapacity" rule was designed to discourage adults from dealing with minors. If an adult knew that she could always get back anything that she transferred to a minor, the adult might be encouraged to make contracts with minors. Also, adults can protect themselves by assuring that parties with whom they contract are 18 years old, or by requiring co-signers to the contract. This will be further explained in Section 4.4d, below.

******* ***CASE STUDY 103***

FACTS Much, a minor, bought a watch for $20 from the S'aht Jewelry Company. About a month later Much lost the watch. While Much was still a minor, he disaffirmed the contract and demanded the return of his $20.

QUESTION OF LAW Can Much get his $20 back even though he cannot return the lost watch?

DECISION Yes. Much can disaffirm and get his $20 back because he was a minor when he made the contract.

Minors can generally disaffirm contracts and get restitution, even if the adult cannot recover everything she provided to the minor under the contract. In this case, the minor Much can disaffirm his watch sale contract and get his money back, even though he cannot return the watch to the Jewelry Company. It does not matter that he is unable to return the watch. Most courts require only that the minor return the goods she still has in her possession--even though the adult must return everything she has received.

One potential problem related to this rule about restitution after disaffirmance is what happens to the property an adult has received from a minor in this situation if that adult no longer has that property. In general, if an adult buys property from a minor, the adult has only voidable title to the property. That is, the minor may recover title--ownership--from the adult if she chooses to disaffirm. In addition, if the adult gives the property away to a third party, or sells it to a third party who knows it came from a minor, it appears that the minor can also get back title to the property.

However, sometimes the adult sells the property to an innocent third party--one who does not know that the property came from a minor--before the minor disaffirms the contract. Such innocent third parties are sometimes called "good faith purchasers for value." The rules for this kind of resale to a good faith purchaser are different for goods and real property.

If this kind of resale occurs with goods, it appears that the innocent third party gets unvoidable title to the property. This means that the minor cannot take back title to the property--although she may still get compensation from the adult with whom she made the contract for the reasonable value of the property.

If this kind of resale occurs with real property, it appears that in some jurisdictions the minor may still be able to reclaim title to the property--even though the adult has sold it to an innocent third party! If the minor reclaimed title in that way, and the third party wanted to recover the value of what she had given under her contract, the third party would have to bring a lawsuit against the adult who made the original contract with the minor. The rights of minors to reclaim title to real property will be further discussed in Section 4.4c, below.

*** ***CASE STUDY 104***

FACTS Vicseth, a minor, owned a 1989 car. But he traded it to an adult named Pochin in exchange for a 1991 car. Vicseth drove the 1991 car

for two weeks, and found that it was not as good as the 1989 car. So Vicseth asked Pochin to return his 1989 car. But Pochin said that he had already sold the 1989 car to Kumnith, who knew nothing about the fact that Vicseth was a minor. Vicseth then sued Kumnith for the return of his car.

QUESTION OF LAW Can Vicseth recover his 1989 car from Kumnith?

DECISION No. Kumnith can keep the car because he is an innocent third party who bought the car in good faith and for value.

In many jurisdictions, if an adult resells goods she got through a voidable contract with a minor to a good faith purchaser for value, the innocent third party gets unvoidable title to the property. This means that the minor cannot take back title to the property--although she may still get compensation from the adult with whom she made the contract for the reasonable value of the property.

In this case, Pochin got a 1989 car through a contract with the minor Vicseth. This means Pochin had voidable title to the car--goods--because the sale of goods contract between Vicseth and Pochin was voidable, and Vicseth had not yet disaffirmed it. So until Vicseth actually disaffirmed the contract it was binding, and it vested title in Pochin.

Then Pochin sold the car to Kumnith. Kumnith was a good faith purchaser for value, since he knew nothing about who owned the car before. Because the car is goods, sale to an innocent third party in this situation gives that third party unvoidable title. So in this case, the sale to Kumnith gave unvoidable title to Kumnith. Vicseth cannot get the car back from Kumnith. However, Vicseth can bring a claim against Pochin for restitution, because the original contract was voidable against Pochin.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 (“Basic Aspects of Contract Law”), Section 1.3c contains further discussion of executory and executed contracts, and Section 1.5 contains further discussion of situations in which courts may apply the doctrine of quasi-contract; and Chapter 10 ("Remedies"), Section 10.4 contains further discussion of restitution, and Section 10.7b contains further discussion of rescission.

4.4b Minors May Ratify Voidable Contracts They Make

Just as a minor may disaffirm a voidable contract, she may also ratify such a contract--but only when she reaches the age of majority. When a minor ratifies a contract, the minor basically says that she does want to perform the contract and gives up the right to avoid it. After that occurs, the minor is legally bound by the terms of the contract, just like the adult.

*** **DEFINITION: Ratification** is a proper confirmation that a party intends to be bound by a voidable contract, despite that party's right to avoid it--basically the opposite of disaffirming a contract.

The big difference between disaffirmance and ratification is that a minor can ratify a voidable contract only after she reaches the age of majority. So if the age of majority is 18 years of age, a minor cannot ratify a contract until she reaches 18 years. In the case of a minor, ratification means some words or conduct showing the minor's willingness to be bound by the promises she made while she was a minor. Of course, although for convenience we will continue to refer to persons in this situation as "minors," in reality they are "ex-minors," since they have just reached the age of majority. It appears that this rule about when minors can ratify is designed to make sure minors are as mature as possible when they make such an important decision.

As with disaffirmance, a minor cannot ratify only one part of a contract. In other words, a minor cannot choose to ratify what she likes and disaffirm what she does not like about a contract.

In addition, as discussed in Section 4.4a, silence by the minor for a reasonable time after she reaches majority has different effects on executory and executed contracts. Where a minor is silent about an executory contract for a reasonable time after reaching the age of majority, this disaffirms the contract. But where that occurs with an executed contract, the law says that such silence by the minor ratifies the executed contract.

*** ***CASE STUDY 105***

FACTS Keary, a wealthy minor, wanted more than anything else to be a landlord. So she rented a house she owned to an adult named Tepirith for one year at the rent of $500 per month.

Three weeks after Keary and Tepirith signed the contract, Keary reached the age of majority. One week after that time, the first month's rent was due, and Tepirith paid it. Keary received and spent the money. Soon afterwards, Tepirith began to complain about the awful condition of the house. Keary did not wish to deal with this problem, so she attempted to disaffirm the contract.

QUESTION OF LAW Can Keary now disaffirm the contract?

DECISION No. Keary can no longer disaffirm because she has already ratified the contract through her conduct.

Minors can ratify their voidable contracts through conduct. In this case, Keary received and spent the first month's rent money after reaching the age of majority--the time when she could legally ratify a voidable contract she made as a minor. Keeping and spending this money at this time is actually a ratification, because it clearly indicates Keary's intention to be bound by the contract. And after a minor ratifies a contract, it cannot later be disaffirmed. So in this case Keary ratified the contract prior to her attempt to disaffirm it, and she can no longer disaffirm it. She must obey it.

4.4c Limits on the General Rule about Minors' Capacity to Make Contracts

There are some limits on the general rule that minors can disaffirm contracts. In some special situations, minors still have the right to disaffirm, but certain limits are placed on that right. In other cases, it appears that the contracts minors make are actually considered to be valid (not voidable), and so minors do not have the right to disaffirm.

We will discuss a total of four special situations which differ from the general rule. However, these special limits may not apply in all jurisdictions. And there may be other limits in some jurisdictions. For example, although this situation will not be discussed in detail, many jurisdictions say that minors cannot avoid agreements they make to support their children born outside of marriage. So it is very important to check the local law in this area.

In any case, the four special situations this text will discuss where some jurisdictions limit the ability of minors to disaffirm contracts are:

(1) contracts for "necessaries;"

(2) business and professional contracts;

(3) contracts based on misrepresentation of a minor's age;

AND (4) real estate contracts.

(1) Contracts of Minors to Buy "Necessaries"

Sometimes a minor makes a contract to buy "necessaries," which are basically things the minor needs to live. Most jurisdictions appear to say that the minor may disaffirm such contracts. In such jurisdictions, minors may disaffirm fully executory contracts to buy necessaries with no liability at all. However, if the contract for necessaries has been performed to some extent, the minor must provide restitution of the reasonable value of necessaries she has actually received under the contract, under the doctrine of quasi-contract. That means the minor must pay for what she has received, though not at the contract price, only the reasonable value. This rule applies whether the minor still has the necessaries or not.

As noted above, "necessaries" are basically what a person needs to live, according to her particular circumstances and standard of living. Exactly what this is can be difficult to determine. Generally necessaries include food, clothes and shelter which have not already been provided for the minor by parents or other guardians. That is why this rule is particularly important for "emancipated" minors who do not receive most of their support from their parents or guardians. Some jurisdictions say that necessaries can also include health care, work tools, education through high school or even university, and other items. Some of these might be considered luxuries, but for some people they may be considered "necessaries," because of the particular circumstances.

*** ***CASE STUDY 106***

FACTS Sok, a minor, needed a new set of clothes. So he purchased one for $20 from an adult named Sitha. But after Sok had received the clothes, Sok refused to pay or give the clothes back, saying that he could disaffirm the contract any time he wanted.

QUESTION OF LAW Is Sok required to pay for the clothes even though he is a minor?

DECISION Yes. Sok can disaffirm, but he must pay for the clothes he received, because clothes are generally "necessaries."

Minors can disaffirm contracts for necessaries, but they must provide restitution of the reasonable value of what they have received. In this case, the minor Sok can disaffirm his contract to buy the clothes from Sitha. However, Sok will be required to pay for the reasonable value of the clothes he received. He may not be liable for the full contract price of $20, unless the court determines that $20 was in fact the reasonable value of the suit.

*** ***WHY IS THIS IMPORTANT?*** What is the reason for this exception to the general rule that says minors are liable for the reasonable value of what they receive under contracts they make to purchase "necessaries?"

In this situation, contract law attempts to balance a minor's need for protection from bad deals with her need to make contracts in certain circumstances. Specifically, minors usually need things such as food, clothing, and shelter, and perhaps certain others, depending on their situation. The law recognizes (and intends) that a minor's incapacity will generally deter adults from contracting with her. But the law also recognizes that this same general rule, by discouraging such contracts, might prevent minors from obtaining what they need to live! This would be especially difficult for emancipated minors who do not receive most of their support from adults.

To solve this potential problem, the law applies this exception to contracts for necessaries. The exception is designed to ensure that adults can contract safely with minors for those things that a minor needs to live. An adult may be reluctant to sell a minor non-necessaries--since there is a risk that the minor may later disaffirm the contract and be required to provide little or no compensation to the adult. But the adult faces no such risk with a contract for necessaries. So the adult need not hesitate to make such contracts.

In fact, as noted in Section 4.4a above, this protection for the adult is actually a kind of quasi-contract. Although there really is no valid contract remaining in these special situations, the law seeks to prevent unjust enrichment of the minor more than under the general rule, in order to motivate adults to deal with minors in these situations, and provide them with

the basic necessities of life. So although it may seem that the law gives minors less power in this situation--less power to disaffirm their contracts with limited liability--the real effect should be to give minors the more important ability to make agreements for these necessities.

(2) Business and Professional Contracts of Minors

In some jurisdictions, contracts that a minor makes as part of that minor's business or profession are binding on both the adult and the minor. So if a minor engages in a business or profession in the same way as a person having full capacity, the minor cannot generally disaffirm contracts that arise from that business or profession. In fact, it appears that such contracts can be fully enforced by the minor or against the minor! Therefore, at least in some jurisdictions, these contracts would seem to be valid.

*** ***CASE STUDY 107***

FACTS Charavuth, a minor, owned a market stall that sold clothes. She bought the clothes on credit from a supplier named Thida. Thida later sued Charavuth for failing to pay her debts for some of the clothes. Charavuth claimed that she was not liable for the debts under these contracts because she was a minor.

QUESTION OF LAW Can Charavuth disaffirm these contracts on the grounds that she is a minor?

DECISION No. Charavuth cannot disaffirm these contracts because they arose out of her dealings as a business person.

In many jurisdictions, minors cannot avoid contracts they make as part of their business or profession, and so such contracts appear to be valid. This is an exception to the rule about capacity which normally applies to minors. In this case, Charavuth cannot disaffirm the contracts she made as part of her business selling clothes at the market. In fact, she is bound as if she were an adult. So she is liable for the actual debts she incurred--not just the reasonable value of what she received under the contracts.

(3) Contracts Based on Misrepresentation of a Minor's Age

Sometimes a minor may lie about her age in order to induce an adult to make a contract with her. When this occurs, most courts still allow the minor to disaffirm the contract. This is true even though the adult may have a more reasonable expectation that the contract will be honored, since the adult may have thought she was dealing with another adult.

However, although most courts allow the minor to disaffirm, they may impose on the "lying minor" a greater burden of restitution to the other party. This means that the minor may have to compensate the other party for

the reasonable value of what the minor received--even if the minor no longer has it. This is similar to the special rule about necessaries. This rule about misrepresentation is more fair to adults who had reason to believe they were making valid contracts with other adults. In addition, it appears that most courts will allow the adult to avoid the contract in this special situation. That would give the adult even more power than under the exception for necessaries! Some jurisdictions also say that the adult may bring an action against the minor for the tort of deceit because of the misrepresentation.

*** ***CASE STUDY 108***

FACTS Narom is 17 years old and lives in a jurisdiction where 18 is the age of majority. Narom sells one damlung of gold to Poly, a local gold dealer, telling Poly that he is actually 18 years old. After selling the gold, Narom throws several huge parties for all his friends with the money he has received.

The next week, Narom returns to see Poly and demands the gold back, saying that he can disaffirm the contract because he is a minor. But when Poly asks for the money he paid Narom for the gold, Narom laughs and says most of it is gone. Narom says that under the law, he is not required to return money he no longer has. Poly asks the court for help.

QUESTION OF LAW Is Narom required to pay Poly the full amount of money he received for the gold?

DECISION Yes, in some jurisdictions. In these jurisdictions, Narom must provide full restitution because his contract was based on misrepresentation about his age.

Most courts allow minors to disaffirm contracts they make by lying about their ages. But some jurisdictions say that minors who lie about their age in this way must compensate the other party for the reasonable value of what they received under the contract. That is, they must provide full restitution. So in this case, courts in some jurisdictions would order Narom to pay Poly the amount of money he received from Poly under their gold sale contract. This is true even though Narom no longer has some of the money.

(4) Real Estate Contracts of Minors

Another important limit some courts make on the right of minors to disaffirm contracts is that a minor cannot fully disaffirm a contract for the sale of real estate until she reaches the age of majority. Before that time, a minor may partially avoid the sale by retaking possession of the property, and using it or renting it to others. But the minor cannot recover the title to the property (actual legal ownership) until reaching the age of majority.

The reason for this limit appears to be that the law views real estate contracts as very important. The law wants to make sure minors are

as mature as possible before they decide whether to fully disaffirm such contracts, just as it does in the situation where minors are considering ratifying contracts.

*** ***CASE STUDY 109***

FACTS Sisawada, a minor, made a contract to sell a small tract of land to Visal. While Sisawada was still a minor, he decided he liked the land after all, since it was a good place to play. So he sought to avoid the sale and recover title to the land.

QUESTION OF LAW Can Sisawada recover title to the land?

DECISION Yes. Sisawada can recover the title to the land he sold, but not until he reaches the age of majority.

Many jurisdictions say minors can disaffirm contracts they make to sell land, and retake possession, but that they cannot get title to such land back until they actually reach the age of majority. In this case, Sisawada can disaffirm the contract immediately on the grounds that he lacked capacity to contract when he made it. This allows Sisawada to take back possession of the land right away, and to use the land. However, he cannot actually recover title to the land until he reaches the age of majority.

4.4d How Parties Can Reduce the Risks of Making Contracts with Minors

As described above, adults generally make contracts with minors at some risk to the adult. So every business person should know how to protect herself from this risk, at least when making important contracts.

One way to guard against this risk is to have an adult (usually a parent or guardian) join in the contract as a co-signer with the minor. This does not bind the minor. But it does give the other party the right to enforce the contract against the adult who became a party to the contract.

*** ***CASE STUDY 110***

FACTS Yarath, a 16-year-old, made a contract to buy a car from Bora for $1200. Yarath agreed to pay the money to Bora in monthly installments of $100 over 12 months. Yarath's father (who had capacity) co-signed the agreement. After the third month, Yarath stopped making payments. The age of majority was 18 years old.

QUESTION OF LAW Can Bora recover the unpaid installments under the contract from Yarath, since Yarath's father co-signed the contract?

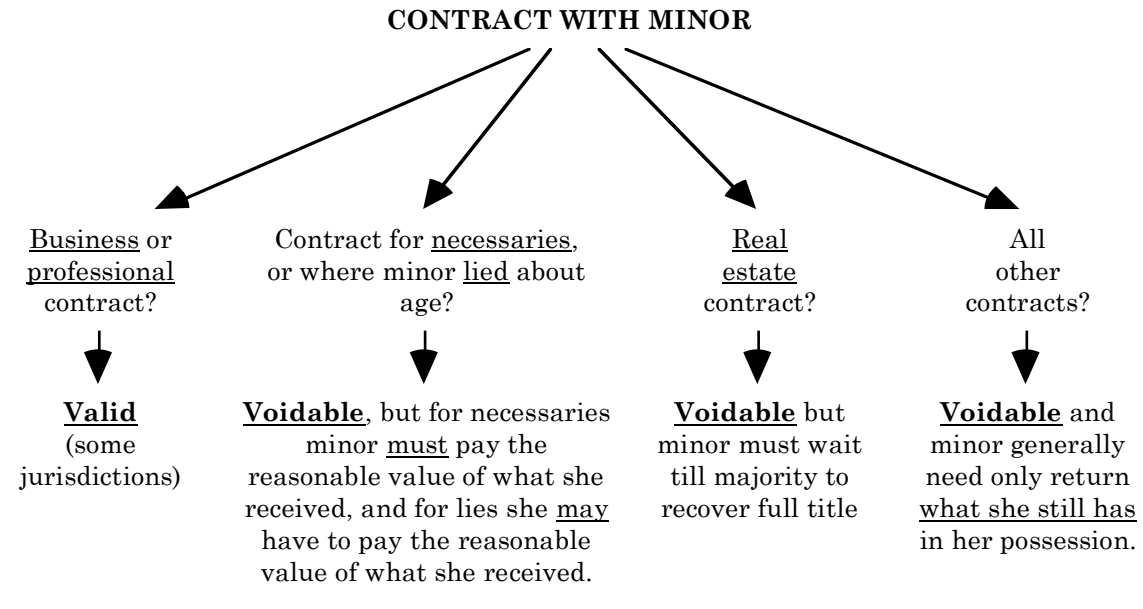
DECISION No. Bora cannot recover from Yarath, since Yarath was a minor when he made the contract, but he can recover against the adult who signed the contract: Yarath's father.

Parties can reduce the risks of making contracts with minors by requiring that an adult with capacity join as a co-signer. In this case, Bora cannot enforce the car sale contract against Yarath, since Yarath can use his lack of full capacity as a defense and avoid the contract. But Bora can enforce the contract against Yarath's father, since his father co-signed the contract. Because the father has capacity, the father's promise to become responsible for the contract obligations of his son Yarath is enforceable.

Of course, the safest way to reduce the risks of making contracts with minors would be to avoid making contracts with minors. But often this is not practical, especially for merchants. And in everyday commercial life, it is often not practical for contracts with minors to include a co-signer. If everyone who contracted with a minor demanded that this occur, it would reduce enormously the number of sales to minors. So in practice a merchant must take some risks when dealing with minors, since minors generally have the right to avoid contracts even years later. However, few minors actually exercise this right. So it is often more profitable for a business person to assume this risk, rather than to seek absolute protection against loss each time she deals with a minor. In practice, the profits from sales to minors greatly exceed the amount of refunds demanded by minors on the grounds of lack of capacity!

4.4e Summary of Some Basic Rules about Contracts Made by Minors

Illustration: Some Basic Rules about Contracts Made by Minors



4.5 Contracts Mentally Incompetent Persons Make Are Generally Either Void or Voidable

In general, a "mentally incompetent" person is someone who has a substantial mental disability. Such persons are sometimes called "insane" persons. But that word may not be appropriate or adequate to describe all the ways persons might be mentally incompetent to make a contract. Mentally incompetent persons, like minors, are considered not to have the ability to make reasonable choices about contracts. Therefore, the law tries to protect them. This Section will discuss persons whose incompetence is not caused by intoxication. Intoxication will be discussed in Section 4.6 below.

Contracts mentally incompetent persons make are generally either void or voidable. In many jurisdictions, agreements of persons who have been adjudicated incompetent are void, while those of incompetent persons who have not yet been adjudicated incompetent are generally voidable. The rules about these agreements will be explained in the following Sections.

In many jurisdictions, courts will generally consider a person to be mentally incompetent to make a particular contract if she:

(1) lacks the mental capacity to understand the nature and consequences of the contract;

OR (2) understands the contract but cannot control her behavior with respect to it and the other party has some reason to know that.

The first part of this rule is the traditional test for whether a person is mentally incompetent to make a particular contract. But some modern courts say a person also lacks the mental competence to make a contract if she understands the transaction, but cannot control her behavior with respect to the transaction--that is, she cannot keep herself from acting irrationally in making the contract--and the other party has a reason to know about this lack of control. For example, this might be the case with someone who suffers from a "manic-depressive" disorder, an illness where the sufferer has episodes where she may do many things in a frantic way and cannot control her behavior. So this is the second part of the modern rule above.

In practice, it is often difficult to determine whether a person actually lacked mental capacity to a sufficient extent at the time she made a particular contract to have the right to avoid it. In fact, there are really two important things courts must consider in making this determination: the nature of the contract, and the nature of the incompetence. Obviously, some contracts are easier to understand than others. A certain person may be able to agree to some contracts, but not other contracts. In addition, mental incompetence may be mild or severe, and it may take very different forms in different people. But a mere weakness of intellect or mind is not grounds for avoiding a contract.

On the other hand, mental incompetence does not have to last long or be permanent in order for an incompetent person to avoid a contract. In fact, the mental incompetence can be temporary, or even momentary. For example, sometimes a particular event can cause a temporary loss of capacity. Someone who has just received a blow to the head in a car accident may not be competent, while she is still groggy or confused from the accident, to make a contract with a cyclo driver to take her to the hospital. This may not fit the common understanding of "incompetent." But it might fit the legal definition we are discussing here: such a person might lack the mental capacity to understand the contract, or control her behavior as to the contract.

4.5a Agreements of Persons Who Have Been Adjudicated Incompetent Are Void

In many jurisdictions, an agreement made by an incompetent person is void if, at the time the contract was made, that person had already been formally adjudicated incompetent by a court. This is true regardless of whether the agreement is reasonable, or what kind of agreement it is. A person who has already been declared incompetent by a court is considered incapable of making a real agreement, no matter how fair or important the contract may appear. Where parties ask courts for assistance with regard to such agreements, it appears that courts generally award restitution.

*** ***CASE STUDY 111***

FACTS Sitek was declared incompetent by a court, which appointed Youran as a guardian to take care of Sitek's affairs. Later Sitek sold his car to Dara for $500, which was a fair price. But Youran still sued Dara for the return of the car.

QUESTION OF LAW Could Youran have the court declare the contract to be void, despite the fact that Dara paid the reasonable value of the car?

DECISION Yes. After Sitek was declared incompetent by the court, any contract he made was void, and so Youran can get Sitek's car back from Dara.

In many jurisdictions, contracts made by parties declared incompetent by a court are void. In these situations, it appears that courts generally award restitution of anything the parties received under the contract. In this case, Sitek had been judicially declared incompetent before he agreed to sell his car to Dara. So his guardian Youran can recover the car Sitek sold to Dara, even though the contract was fair.

*** ***WHY IS THIS IMPORTANT?*** Why does the law treat judicially declared incompetent persons differently from undeclared incompetent persons? Why does it say that judicially declared incompetent persons' contracts are void, rather than voidable?

In many jurisdictions, the main reason such contracts are void, rather than voidable, is that when a court officially declares a person to be incompetent, the court appoints a guardian to handle the incompetent person's affairs. From that point on, the incompetent person does not have the authority to make her own contracts. So any contract made with her is really no contract at all, unless the court-appointed guardian consents. The guardian is the only person with the power to make such a contract for the person who has been declared incompetent. This helps the guardian to do her job of protecting the incompetent person.

The effect of this rule seems to be to discourage persons from contracting with those who have been adjudicated incompetent even more strongly than the law discourages contracting with minors. That is because it appears that no one (not even the incompetent person or her guardian) can enforce such a contract. It may be that the law believes these judicially declared incompetent persons need even more protection than minors.

4.5b Contracts of Incompetent Persons Who Have Not Been Adjudicated Incompetent Are Generally Voidable

If a person is incompetent at the time she makes a contract, but she has not been declared incompetent by a court at that time, then that contract is generally voidable. So such a person can avoid--disaffirm--such a contract if she wishes. This gives such a person about the same protection as a minor. The reasons for this protection are also similar to those for the protection of minors: to protect persons who are unable to protect themselves from their own lack of full competence, and from the unscrupulous conduct of others, and also to deter others from making contracts with such persons. Of course, like a minor, an incompetent person may also ratify a voidable contract, either expressly or by her conduct.

However, an important difference between minors and unadjudicated incompetent persons is that it appears that an unadjudicated incompetent person can disaffirm or ratify only after she has acquired capacity, or before then through a guardian--but not by herself while she is still incompetent. By contrast, minors can disaffirm by themselves even before they gain full capacity at the age of majority. Of course, in practice, if a party tried to enforce a contract against an unadjudicated incompetent person who had not yet recovered from her incapacity, it seems likely that the incompetent person would be able to find a guardian to help her disaffirm--perhaps through the court that was asked to enforce the contract.

Of course, a court will not allow anyone to avoid a contract just because she claims to be incompetent! In fact, when an unadjudicated incompetent person asks a court to help her avoid a contract, that court must carefully examine all the evidence to see whether the person was sufficiently "incompetent," under the rules explained in Section 4.5 above, at the time the contract was made.

In addition, if an undeclared incompetent person disaffirms a contract, she must generally return anything of value which she has received under the contract. That is, she must provide restitution. It appears that most courts require the incompetent person to return what she has received even if she no longer has the item, although some jurisdictions do not require this if the other party took advantage of the incompetent in some way. This requirement for incompetent persons is more strict--harder on the person with the right to avoid--than the general rule about what happens when minors disaffirm contracts. This may be because it is usually fairly easy to determine whether someone is a minor. But it is often less certain whether a court would consider an adult to be "incompetent." Perhaps for this reason, the law gives greater protection to persons who contract with those whom a court later finds to be mentally incompetent.

*** ***CASE STUDY 112***

FACTS Narom is incompetent. Before any court can declare him incompetent, however, he makes a contract to work as a night guard for one year at the headquarters of the Prosperity Company. The manager gives Narom a new flashlight, as provided in the contract, and tells him to return next week for his first night of work.

However, a few days later, Narom regains his competence and realizes that this new job may cause him to miss some of his favorite television programs. So he immediately returns to the Prosperity Company and disaffirms his contract.

QUESTION OF LAW Can Narom avoid his contract in this way?

DECISION Yes. Narom can avoid this contract because he was mentally incompetent at the time he made it.

Contracts made by those who are mentally incompetent are generally voidable. In this case, Narom was incompetent at the time he made his employment contract with the Prosperity Company. But he had not been declared incompetent by a court. So this contract is voidable. Narom can avoid it if he wishes, either after regaining his capacity, or before then through a guardian. In this case, Narom regained his capacity.

However, when mentally incompetent persons disaffirm their voidable contracts, they must generally provide restitution of whatever items they have received under the contracts. Therefore, in this case, Narom must return the flashlight to the Prosperity Company.

4.5c Temporary Incompetence

As noted in Section 4.5 above, temporary incompetence occurs where someone suffers mental incompetence which is not permanent. That is,

it occurs where someone is incompetent only for a limited time, and the person later regains competence.

Where someone regains her competence after a period of temporary incompetence, there are two different rules about how that person regains her capacity. Where a court has already declared someone to be incompetent, most courts say that person does not regain capacity to contract until a court officially declares that person to be competent again. But where a person has not been judicially declared incompetent, that person regains her full capacity to contract automatically at the time she actually regains her competence.

4.5d Limits on the General Rule about Incompetent Persons' Capacity to Make Contracts

As is the case with minors, there are some limits on the general rule that mentally incompetent persons can disaffirm contracts if they wish to do so. Two of these limits relate to:

(1) contracts for necessaries; and

(2) fair contracts where disaffirmance might be unjust to the other party who had no reason to know of the incompetence.

However, as with the rules about minors, these limits may not apply in every jurisdiction, and other limits may apply in some jurisdictions. So it is important to check the local law in this difficult area.

The first of these limits applies to contracts which incompetent persons make to purchase "necessaries." As is the case with minors, incompetent persons may disaffirm such contracts. However, the incompetent person is liable for the reasonable value--restitution--of any such necessaries she has received. As with minors, it appears that an incompetent person may disaffirm a fully executory contract for necessaries with no liability. However, if the contract is partly or fully executed, the incompetent person must pay the reasonable value of anything she has already received under the contract, whether she still has it or not. Actually, this limit is close to the general rule about voidable contracts by incompetent persons, under which most courts say such persons must return whatever they have received to the other party. The only difference appears to be that this special rule as to "necessaries" seems to be applied just about everywhere, whereas it is not clear that so many courts apply the general rule that incompetent persons must return whatever they have received.

The second limit on the general rule as to incompetent persons is applied only in some jurisdictions. Under this limit, an undeclared incompetent person cannot disaffirm a contract if:

(1) the contract is fair to the incompetent person;

(2) the person with whom the incompetent person contracted had no reason to know of the incompetence;

AND (3) allowing disaffirmance by the incompetent person would be unjust to the other party.

It appears that a contract that met all of these requirements would be valid in these jurisdictions. However, if a contract fails to meet any one of these requirements, then these jurisdictions say that the incompetent person may disaffirm the contract.

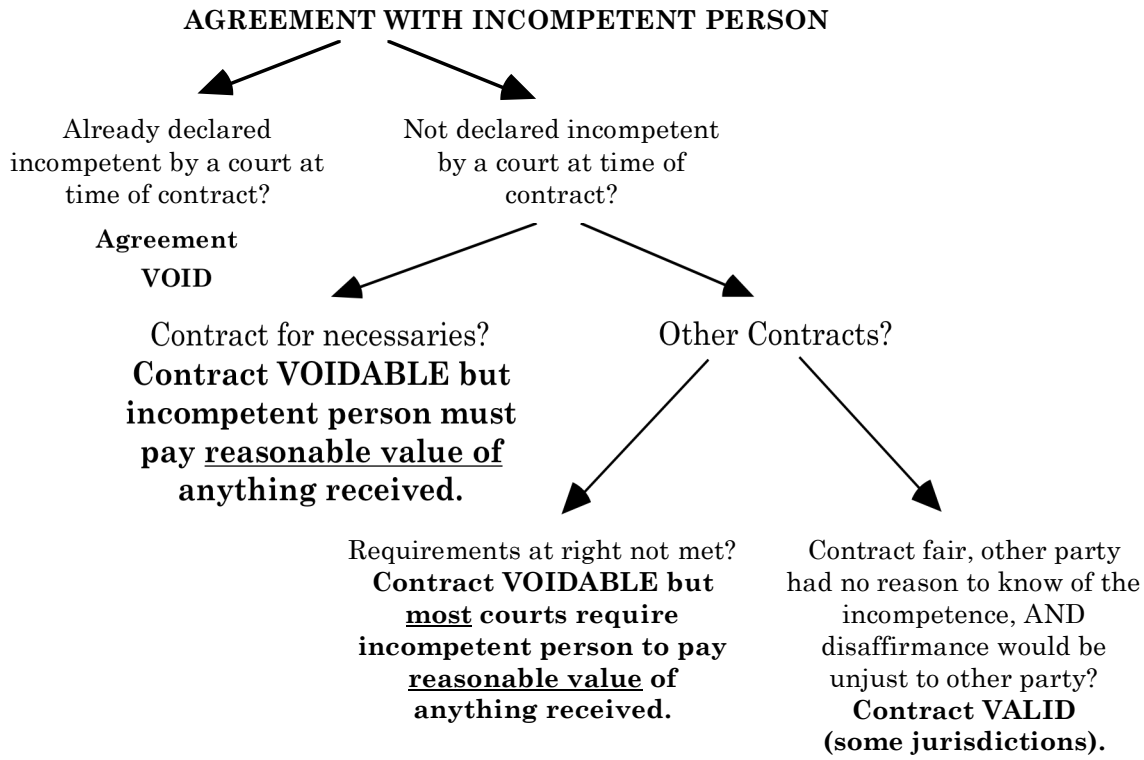
For example, in the Case Study 112 situation, suppose Narom's guard contract was fair, and that the Prosperity Company had no reason to know of his mental incompetence, because he seemed about the same as anyone else. Finally, suppose Narom's disaffirmance would cause the Company to need to pay a much higher salary to a temporary guard for a few weeks until it could find another permanent guard. But it could not recover for that cost if Narom was permitted to disaffirm, since Narom would be required only to return what he had received from the Company. So allowing Narom to disaffirm might be unfair to the Company. In that situation, some jurisdictions might say the contract was valid. If Narom did not properly perform, courts would probably not order him to perform, because of difficulties in enforcing orders like that. But they might order him to provide the Company with some other remedy to compensate it for the damage his failure to perform caused.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 (“Remedies") contains further discussion of remedies courts may order.



4.5e Summary of Some Basic Rules about Contracts Made by Incompetent Persons

Illustration: Some Basic Rules about Contracts Made by Incompetent Persons



4.6 Contracts Intoxicated Persons Make Are Often Voidable

Contracts made by persons who have become so intoxicated through drugs (including alcohol) that they lack capacity are often voidable, although they may be valid, depending on the situation. An intoxicated person generally lacks capacity if she cannot understand the meaning of the contract, or cannot control her behavior with respect to the contract. The legal standard for how much intoxication is required for such contracts to be voidable is generally similar to the standard for mentally incompetent persons.

Contracts made by intoxicated persons are often voidable. Specifically, such contracts are voidable if the persons are sufficiently intoxicated because they are:

(1) taking medication for an illness;

(2) drugged involuntarily; OR

(3) drugged voluntarily and the other party had reason to know of the intoxication.

However, contracts made by intoxicated persons are valid if the person is voluntarily intoxicated for reasons other than illness and the other party has no reason to know of the intoxication. Of course, contracts made by intoxicated persons are also valid if the intoxicated person does have sufficient capacity to make the contract despite the intoxication.

*** ***WHY IS THIS IMPORTANT?*** What is the reason for the rule that the contracts of persons who are voluntarily intoxicated for reasons other than illness are valid if the other party has no reason to know of the intoxication?

The reason for this rule is that courts are generally reluctant to allow avoidance of a contract because of voluntary intoxication. Courts want to discourage voluntarily intoxicated people from making contracts, because this can lead to many problems that could probably have been avoided. Courts also wish to protect the reasonable expectations of the other parties.

So courts will allow a voluntarily intoxicated person to avoid a contract only where the other party has made a contract with someone who was clearly incompetent--where the other party had reason to know about the impairment. An example of this would be where the person was obviously drunk, perhaps stumbling and slurring her speech, when she made the contract. Of course, courts may have trouble deciding whether the other party had "reason to know" about the intoxication. It is not clear exactly how impaired a person's behavior must be before the other party has "reason to know" about the intoxication.

To decide whether a person is so intoxicated that she lacks capacity to contract, the law asks whether the person did not, at the time of making the contract, have the mental capacity to understand the nature and consequences of what she was doing, or whether she understood but could not control her behavior in making the contract. In order for the contract to be voidable, the intoxicated person's ability to reason and make judgements must really be impaired to the extent required--a lower level of intoxication is not enough. Of course, this is basically the same analysis as the law makes for mentally incompetent persons, as discussed in Section 4.5, above.

*** ***CASE STUDY 113***

FACTS Sochivin spent all afternoon playing billiards and drinking beer. Eventually he became very drunk. As he stumbled past the market on his way home, he saw a shirt he really liked in Dararith's shop. Sochivin asked Dararith what the price of the shirt was. Dararith could see how drunk Sochivin was, so although the shirt normally cost 10,000 riels, Dararith said the price was 20,000 riels. In response, the drunken Sochivin offered to pay 30,000 riels for the shirt. Dararith thought carefully, then accepted this offer. The parties exchanged the money for the shirt.

The next day, when Sochivin woke up and saw his new shirt, he decided that he did not like it so much after all. In addition, he could not afford it. So he returned to the market with the shirt and asked Dararith for his money back. But Dararith said the contract was binding.

QUESTION OF LAW Can Sochivin avoid this contract with Dararith on the grounds that he lacked capacity?

DECISION Yes. This contract is voidable because, even though Sochivin was drunk voluntarily, Dararith could see that Sochivin was drunk when he made the contract.

Contracts made by parties who lacked capacity because they were drugged voluntarily are voidable if the other party had reason to know of the intoxication. In this case, the drunken Sochivin bought a shirt from Dararith, who could see that Sochivin was drunk. Sochivin can avoid this contract because, although Sochivin became drunk voluntarily, it was apparent that he was drunk, and Dararith took advantage of the situation. So Sochivin can disaffirm the contract, return the shirt and get his money back.

The result in Case Study 113 would be the same even if the price had been fair. The reason is that Sochivin was obviously drunk when he made the contract. And where a person who was voluntarily intoxicated wishes to disaffirm a contract, the law requires only that the other party had reason to know of the intoxication--such as if the person was obviously drunk. The fairness of the contract is not part of the analysis. Sometimes it is not wise to make a contract even when the price is fair, such as when a person cannot afford to pay that price. A mistake like that could result in a great loss of money, and could affect not only the intoxicated person, but also her family. The law wishes to protect clearly intoxicated persons from such mistakes.

However, if Dararith had no reason to know that Sochivin was intoxicated--such as if Sochivin had somehow managed to conceal this fact--then the contract would have been valid. In that case, Sochivin would not be allowed to avoid the contract. This rule is designed to protect the reasonable expectations of the other parties to such contracts.

4.6a Disaffirmance and Ratification of Contracts Made by Intoxicated Persons

The general rules about disaffirmance and ratification by intoxicated persons are similar to the rules that apply to unadjudicated mentally incompetent persons. These rules were discussed in Section 4.5b above.

When an intoxicated person who has the right to disaffirm becomes sober, she may disaffirm any voidable contracts she made while intoxicated, as Sochivin could in Case Study 113. But it appears that many courts will not allow an intoxicated person to disaffirm without providing restitution to

the other party of anything the intoxicated person received under the contract--even if she no longer has what she received. The reasons for this rule are similar to those for the disaffirmance rule about unadjudicated incompetent persons. It may also be that courts wish to discourage intoxicated persons from making contracts. If a person delays unreasonably in disaffirming a contract she made while intoxicated, she may lose the right to disaffirm the contract. Intoxicated persons may also ratify contracts once they become sober. As with minors and mentally incompetent persons, disaffirmance and ratification by intoxicated persons may be express or implied.

4.6b Limits on the General Rule about Intoxicated Persons' Capacity to Make Contracts

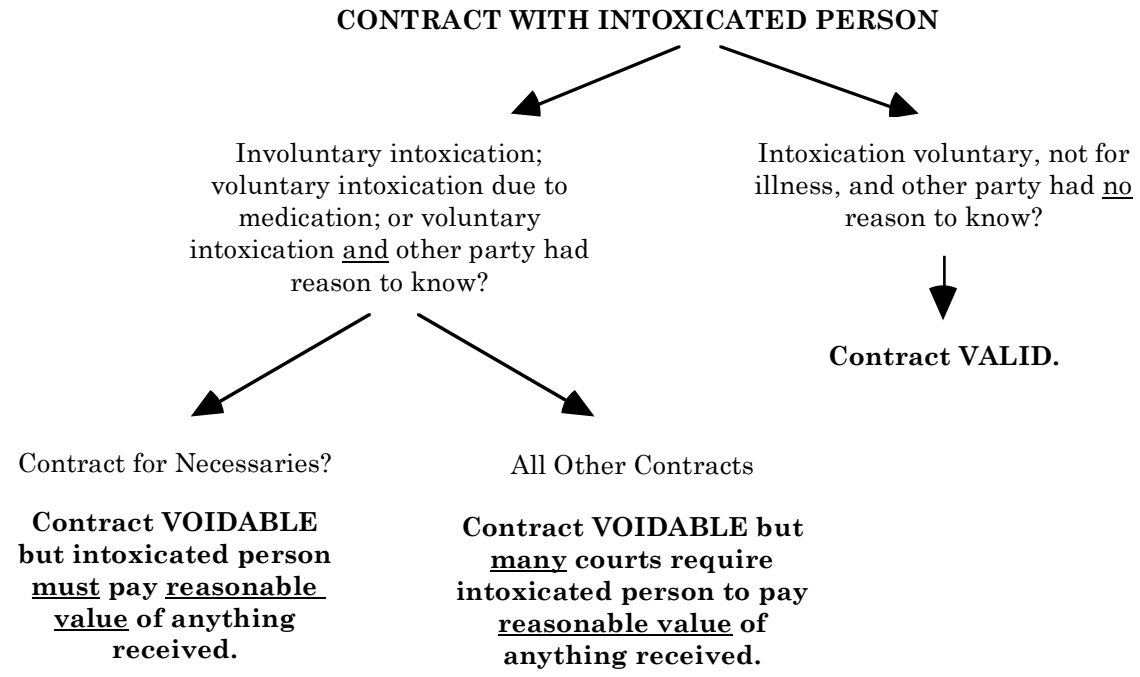
As is the case with minors and mentally incompetent persons, there are some limits on the general rule that intoxicated persons can disaffirm contracts if they wish to do so. First, as with other groups of persons who lack full capacity, an intoxicated person is liable for the reasonable value of any necessaries provided to her. And as with incompetent persons, the only difference between this exception and the general rule seems to be that the "reasonable value" requirement of the exception is applied everywhere. In contrast, the requirement in the general rule that intoxicated persons return whatever they have received does not seem to be applied everywhere.

There may be other limits in different jurisdictions. So it is very important to check the local law in this area.



4.6c Summary of Some Basic Rules about Contracts Made by Intoxicated Persons

Illustration: Some Basic Rules about Contracts Made by Intoxicated Persons



4.7 Persons Convicted of and Imprisoned for Serious Crimes May Have a Limited Capacity to Make Contracts

Many jurisdictions limit the capacity of a person convicted of and imprisoned for a serious crime to make a contract. The laws of various jurisdictions differ in this regard.

Generally, such limits apply only to a person convicted of a major criminal offense, such as a felony. Some jurisdictions place a partial disability on a convicted person's capacity to contract. For example, in some jurisdictions, such persons cannot make a valid transfer of property. Other jurisdictions place a total disability on such a person's capacity, which would appear to mean any agreements she made would be void. These rules may further punish the convicted person, and perhaps protect the public from persons who are being punished for crimes. However, the rules could also protect the convicted person, who might have trouble starting or defending lawsuits about her contracts from prison.

In any case, it appears that such disabilities generally last only while the convicted person is imprisoned. After the convicted person is released, she can generally make valid contracts like anyone else.

*** ***CASE STUDY 114***

FACTS Song lived in a jurisdiction where persons convicted of serious crimes lacked any capacity to make contracts while they were in prison for such crimes. Song was convicted of armed robbery and sent to prison for two years.

On the day after Song was released from prison, he made a contract to buy a shipment of tanks from the Peacekeeper Corporation. But later Song decided he did not want to buy tanks after all. He sought to avoid the contract on the grounds that he lacked capacity to make a valid contract because he had been convicted of a serious crime.

QUESTION OF LAW Can Song avoid this contract on the basis of incapacity?

DECISION No. Song had full capacity to contract when he made the contract.

Some jurisdictions limit the capacity of parties who are convicted of and imprisoned for serious crimes. In this case, Song was convicted of a serious crime--armed robbery--and sent to prison. However, although Song lacked capacity while he was in prison, he regained full capacity when he was released. So when he was released and then made a contract to buy some peacekeeping equipment, the contract he made was valid--assuming there were no other problems with the contract, such as legality.

4.8 Foreigners Generally Have Full Capacity to Make Contracts

A foreigner is a citizen of a nation which is different from the nation in which she is located, or the nation with which she is conducting affairs. Although previously some nations limited the rights of foreigners to make contracts, foreigners now generally have the capacity to make valid contracts in free market nations.

Some nations do restrict the ability of foreigners to own land. In these nations, contracts involving the sale to foreigners of land covered by such laws would probably be void. For this reason, these contracts could not be enforced, and they would probably be illegal as well. In any nation, analyzing whether such laws are a good idea would probably require balancing the effects of the laws in protecting the nation from foreign control and the increased investment that may occur if foreigners are allowed to own land.

Another important exception to the general rule that foreigners have full capacity to make contracts occurs when the foreigner's nation is actually at war with the nation of the other party to the proposed contract. In this situation, the foreigner is often considered to be an "enemy" foreigner. In many jurisdictions, it appears that any new contracts such foreigners make

with citizens of the jurisdiction are void, and that the foreigner cannot enforce existing ones in that jurisdiction. However, an "enemy" foreigner may still make a defense in court when sued about an existing contract. The reason for this exception appears to be to hurt the enemy nation, and to control the war effort against that nation by not allowing trade with it. In any case, when the war is over, the "enemy" foreigner regains her usual capacity to contract.

*** ***CASE STUDY 115***

FACTS Pheap makes a contract to buy a large quantity of electrical wiring from Phuong, a citizen of a foreign nation with which Pheap's nation is not at war. Before delivery occurs, Pheap decides he no longer wishes to go through with the contract. He tells Phuong that he is disaffirming the contract, arguing that he can do that because Phuong is just a foreigner.

QUESTION OF LAW Can Pheap avoid this contract because Phuong is a foreigner?

DECISION No. The contract for the sale of the electrical wiring is valid and Pheap cannot avoid it.

Foreigners generally have the capacity to make valid and enforceable contracts like anyone else, unless some exception applies. In this case, the nations of Pheap and Phuong are not at war with each other, and there is no other reason the contract would not be valid. So the contract for the sale of the wiring is valid. Pheap must honor the contract or provide a remedy.

*** ***WHY IS THIS IMPORTANT?*** Why do free market nations say that foreign citizens generally have the capacity to make valid contracts in the same way as citizens of those nations?

There are several reasons why foreigners are generally allowed to make valid contracts like anyone else. First, it would be economically unwise to refuse to enforce contracts made by foreigners, because this would deter foreign trade and investment. A foreigner would be less likely to deal with a nation if she thought that her contracts would not be enforced there, because she would have no good way to protect her business! The result of this would be to isolate the nation that refused to enforce such contracts from the global economy. This would probably make economic development more difficult to achieve. In addition, it would probably be poor foreign relations to discriminate against foreigners in the enforcement of contracts without a very good reason, such as an actual war. This is because the foreign government and the people of the foreign nation would be very unhappy with such a policy--it would hurt them economically and otherwise. Another potential reason for the general rule is that, in most cases, it would seem unfair to discriminate against persons and businesses solely on the basis of their nationality, which is not relevant to their ability or character in performing the contract.

4.9 Capacity in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches to capacity of the current Cambodian Contract Law (Decree #38D) and the civil law tradition are generally compatible with the approach discussed in this Chapter. In fact, there appear to be no significant differences, except possibly the Cambodian provisions related to "interdicted persons," as discussed below.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) and other Cambodian laws contain many provisions relevant to our discussion of "Capacity." Some of these are discussed below.

Basic Provisions

Article 3 of Decree #38D explicitly requires that, for a contract to be valid, the contract must be made by "parties who have capacity to enter into a contract." In addition, Article 6 provides that a contract is voidable if a party to the contract lacks capacity. And Article 16 provides that persons who contract with those who lack capacity cannot avoid the contract on the grounds that the other party lacks capacity. All of these basic provisions are consistent with the general law about capacity discussed in this Chapter.

Article 1 discusses who generally has capacity. It provides that both "natural persons" and "legal entities" can be parties to contracts. Presumably this means that not only human beings but also legal organizations such as corporations and government bodies can make contracts. This is consistent with the law discussed in this Chapter.

Rights of the Parties Where One Party Lacks Capacity

Articles 16 and 19 of Decree #38D describe the rights of the respective parties where one party lacks capacity. Article 19 provides that where a contract is voidable because of incapacity (or other defects), the "aggrieved party" or "any person who has a lawful interest in the claim" may avoid the contract. Article 16 states that, if one party to a contract lacks capacity, the other party cannot avoid the contract on the basis that the first party lacks capacity. These provisions seem basically consistent with the law discussed in this Chapter.

Minors and "Interdicted Persons"

Article 14 of Decree #38D provides that "all persons who are fully 18 years old can enter into a contract at any time, except interdicted persons as provided in the law."

Minors

Under Article 14, the age of majority in Cambodia is 18 years old. This means that persons under 18 lack full capacity, and that contracts they make are voidable, under Article 6. This is consistent with the principles discussed earlier in this Chapter.

Article 15 talks more specifically about the capacity of minors to contract. It states that minors cannot "create rights or duties" nor make a contract without consent from a guardian. This language, which seems absolute, might be read to mean that no one could enforce such an agreement. If it meant that, it might conflict with Article 6, which states that every contract made by a party lacking capacity is voidable (not void). So perhaps Article 15 means that minors cannot generally create their own contract duties, or that minors can create only duties they can avoid.

Article 15 does seem to make contracts of minors enforceable by the other party in two special situations. First, Article 15 provides that a contract made by a minor without her guardian's consent can be "executed" if the guardian agrees to the contract after it has been made. It is not clear if this would bind the minor, the guardian, or both.

As for the second special situation, Article 15 provides that a minor does not need the consent of a guardian to make contracts "to meet every day life needs." This exception would seem to be the equivalent of the exception discussed above for contracts involving necessaries. It is not clear how the other rules discussed earlier might apply under Decree #38D, such as whether the minor is liable for the actual contract price, or for the reasonable value. It may be that contracts to meet “every day life needs” under Article 15 are actually valid, since there is nothing to suggest otherwise in the Decree. If such contracts were valid, it would be somewhat different from the law we have discussed, which says such contracts are still voidable but that the minor must pay the reasonable value of necessaries received.

Interdicted Persons

Article 14 also provides that “interdicted” persons lack capacity, and it appears that contracts of such persons would (like those of minors) be voidable under Article 6. It is not clear from Decree #38D who the “interdicted” persons in Article 14 are. However, a definition of this term has been found in a pre-1970 Cambodian legal glossary which has been appended to the current Cambodian Land Law (Decree #100D (1992)). The definition of an interdicted person given in this source is “a person of low awareness and intelligence, a stupid person, or a person convicted by either the penal law or the civil law and restrained from having the freedom to administer his own property.”

The first parts of this definition of “interdicted” persons (“low awareness and intelligence” and “stupid”) appear roughly to accord with the limits

discussed above with regard to the ability of mentally incompetent persons to contract. It is not clear how incompetent a person would have to be to meet this definition. Under the approach we have discussed in this Chapter, a mere mental weakness is not incompetence if the person was actually able to understand the contract at the time it was made. Decree #38D's definition of interdicted persons would arguably include intoxicated persons also, since they also might have "low awareness and intelligence" when they are intoxicated. As noted above, it seems that contracts made by such persons of "low awareness and intelligence" are voidable under Article 6, since that Article says contracts of persons who lack capacity are voidable. This is basically consistent with the approach discussed in this Chapter. However, it is not clear if "interdicted persons" are must pay for any "necessaries" they purchase, as is the case with incompetent and intoxicated persons under the law discussed in this Chapter. It may be that this exception does not apply to interdicted persons, since the exception is contained in Article 15 about minors, but is omitted from Article 14 about interdicted persons. In addition, there is no reference to any possibility that contracts of interdicted persons may be void, as are the contracts of persons who have been adjudicated incompetent in some other jurisdictions.

The second part of the definition of "interdicted persons" is more difficult. It appears to mean that persons lack contractual capacity if: (1) they have been "convicted" under either the penal law or the civil law; AND (2) they have been "restrained" (presumably by a court) from having the freedom to administer their own property. This appears to mean that, where a person has been "convicted" of something, courts have the option to declare such persons to be "interdicted" or not. It is not clear what standards courts may apply here. If there is no other limit on this judicial discretion, it would appear to be different from the law in many other jurisdictions. Such jurisdictions may place limits on the contractual capacity of persons convicted of serious crimes while they are in prison, but those jurisdictions do not generally appear to give courts this kind of discretion to take away capacity.

In addition, it appears that contracts made by such "interdicted persons" are voidable, under Article 6. If this is the case, it would seem to be the interdicted person who could avoid the contract if she wished, since the other party cannot avoid the contract, under Article 19. This would mean that the law would be providing the same legal protection and advantage to those convicted of crimes as it does to minors and the mentally incompetent. It is not clear if this is the meaning of Article 14.

Foreigners and Land Contracts

Decree #38D does not appear to create any general restriction on the capacity of foreigners to make contracts. However, several other Cambodian laws provide that foreigners cannot own Cambodian land, which would appear to have the effect of making any contract to sell Cambodian land to foreigners void. In particular, the Constitution of Cambodia (1993) states in Article 44

that "[o]nly Khmer legal entities and citizens of Khmer nationality shall have the right to own land." It is not clear who "Khmer legal entities and citizens of Khmer nationality" are under this provision. In addition, the Investment Law of Cambodia (1994) in Article 16 basically says that only Cambodian citizens or entities can own the land used for the investment activities promoted by that Law. Moreover, Article 2 of the Land Law of Cambodia ((Decree #100D) 1992) appears to limit land ownership to Cambodians, although that provision actually speaks in terms of possession and use; Article 1 of the Land Law appears to reserve ownership to "the State." In any case, the basic result of these laws would appear to be that foreigners lack capacity to make contracts to buy Cambodian land, and that would make such contracts void. Such contracts would also be void because they would be illegal, which will be discussed in more detail in Chapter 5 ("Legality").

*** ***CIVIL LAW PERSPECTIVE:*** It appears that the civil law approach to capacity is generally compatible with the approach discussed in this Chapter.

For example, certain provisions of the French *Code Civil* relate to capacity. Under Article 1123, "everybody is free to contract, so long as the law does not declare these persons incapable." According to Article 1124, such incapable persons include non-emancipated minors (minors who have not persuaded a court that they should be treated legally as adults) and "protected adults." Protected adults appear to include persons such as those described in this Chapter as mentally incompetent. Contracts of such incapable persons are <u>voidable</u>, since the law believes it is important to protect them. In addition, as in the approach discussed in this Chapter, contracts made by incompetent persons in France may be disaffirmed or ratified. A "protected adult" may ratify a contract after her mental troubles are over and she has regained capacity to contract.

In addition, under French law, contracts are <u>void</u> when they are contrary to public policy. And it appears to be contrary to public policy for certain kinds of persons to have full capacity to contract.

Of course, the exact rules about capacity often differ from one jurisdiction to another. So it is important to check the relevant local law.

4.10 Questions for Review

CHAPTER 4 -- QUESTIONS FOR REVIEW

1. Who generally has the capacity to make contracts?

2. List five types of persons who may not have full capacity to make contracts.

3. What is the legal status of most contracts made by minors?

4. Why does the law have the rule described in your answer to Question 3?

5. What does disaffirmance mean?

6. What does ratification mean?

7. Describe four situations where a minor's ability to avoid a contract may be limited.

8. How can a person contract more safely with a minor?

9. When is a person considered to be mentally incompetent?

10. When are contracts void, and when are they voidable, on the basis of mental incompetence?

11. When are contracts voidable on the basis of intoxication?

12. What are some possible restrictions on the capacity of persons convicted of and imprisoned for serious crimes?

13. Do foreigners generally have capacity? What are some possible restrictions on the capacity of foreigners?

14. Is the approach to capacity discussed in this Chapter generally compatible with the current Cambodian law's approach to capacity?

15. Is the approach to capacity discussed in this Chapter generally compatible with the civil law approach?

CHAPTER FIVE

LEGALITY

5.1 Introduction

Legality is a basic requirement for valid contracts in free market jurisdictions. This was briefly explained in Chapter 1 ("Basic Aspects of Contract Law"). Courts generally will not enforce agreements that are illegal. Illegal offers cannot result in valid contracts. In fact, an "illegal contract" is a contradiction in terms, because by definition a contract is an agreement that the law will enforce. So it is more accurate to use the term "illegal agreements."

Agreements may be unenforceable for different reasons. Section 5.2 discusses the general reasons why agreements that violate the law are generally unenforceable.

Some agreements are illegal because they violate a specific statute. By "specific statute," this text means a statute that discusses the actual subject matter of the agreement, such as the sale of heroin. This text discusses how agreements may be illegal because they violate statutes regarding crimes or torts, gambling, usury, regulatory licensing requirements, and unreasonable restraints of trade. This kind of illegality is explained in Section 5.3 below.

Other agreements are illegal because they violate the more general principle of public policy, even if they do not violate specific statutes. "Public policy" basically means the promotion of the good of society. Principles of public policy may be stated in statutes, or they may be developed in court decisions, particularly in common law jurisdictions. This text discusses agreements that may violate public policy because they involve the commission of torts, harm the freedom of marriage, harm the administration of justice, harm public service or interfere in public affairs, unreasonably restrain trade, promote immorality, or contain improper exculpatory clauses. Agreements that violate public policy are discussed in Section 5.4.

An agreement may be illegal in some jurisdictions because it violates a specific statute, and illegal in other jurisdictions because it violates public policy. But whether agreements are illegal because of statutes or public policy, the effects on the agreement are generally the same.

The general effect of an illegal agreement is that it is void, and unenforceable by any party. And in general, courts will not give any remedy to parties to such agreements--even if the result is that one party profits and another has a loss! However, there are several limits on this rule. In a few special situations, one of the parties may actually be able to enforce the illegal agreement. And in a few other situations, one party can get restitution of what he has provided to the other party or possibly other remedies, even though the agreement is void. Also, if only part of an agreement violates the law, courts may "sever" that part and enforce the rest of the agreement. So such agreements might be considered partly void and partly valid. The effects of illegal agreements are discussed in Section 5.5.

As with other areas of law, the exact rules about legality vary in different jurisdictions. However, there are some basic principles about the kinds of agreements free market courts will not enforce because of illegality. This Chapter discusses many of these basic principles.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4d contains a more concise discussion of the formation requirement of legality.

5.2 Why Agreements That Violate the Law Are Generally Unenforceable

As noted in Section 5.1, courts in free market jurisdictions generally will not enforce agreements that violate the law. This is true even though the law generally wants to promote the enforcement of contracts, in order to protect the reasonable expectations of the parties, and promote economic activity.

The reasons the law will not enforce illegal agreements may seem obvious. But it may be useful to discuss them, in order to help think about which agreements should be considered "illegal."

*** ***WHY IS THIS IMPORTANT?*** Why do courts in free market jurisdictions refuse to enforce agreements that violate the law?

There are several reasons courts generally will not enforce such agreements, despite the general policy to enforce real agreements. First, many laws are designed to protect the public. Enforcing contracts that violated such laws would hurt the public. An example would be an agreement to commit murder for money. To enforce such an agreement could encourage murder because, although the killer might risk going to jail, he might be more willing to take that risk if he knew his fee would waiting for him when he was released from jail. And obviously, courts do not wish to actually order a party to perform an agreement that would mean committing a crime!

Second, the law wants to protect the integrity of the court system. In most societies, courts are the primary places where law is applied. Courts

should try to achieve justice, and to promote the rule of law, which will be discussed in more detail in Section 5.4a, below. In most cases, if courts enforced illegal agreements, they could not achieve justice or promote the rule of law.

Third, such agreements may be unenforceable because the law wishes to punish the parties who made the agreements for breaking the law, or agreeing to break the law. And the law wishes to deter such agreements. Of course, in some cases, one party to the agreement may be relatively "innocent" compared to the other party. An example would be agreements that violate laws designed to protect persons like one of the parties to the agreement, such as minimum wage laws. In limited situations like this, the law may allow some remedy for the more "innocent" party, but none for the more "guilty" party. This will be discussed in more detail in Section 5.5, which explains the effects of illegality.

5.3 Agreements Prohibited by Specific Statutes Are Generally Unenforceable

As noted in Section 5.1, agreements may be illegal because their performance violates a specific statute. There are many different kinds of statutes, criminal and civil, that agreements might violate.

In many jurisdictions, different government bodies--usually in the executive branch--issue detailed administrative regulations to help put statutes into practice. The legislature may not have the time or expertise to regulate by itself certain areas that are very complex--such as communications or health care--so executive bodies do so with regulations. As with statutes, courts will not generally enforce agreements that violate these regulations. For convenience in this Chapter, we will simply refer to statutes. But the same basic rules would apply to agreements that violated valid regulations.

In this Section, we will discuss some of the more important kinds of agreements that may be unenforceable because they violate specific statutes. These are agreements that violate:

(1) criminal or tort statutes;
(2) gambling statutes;
(3) usury statutes;
(4) regulatory licensing statutes; or
(5) unreasonable restraint of trade statutes.

5.3a Agreements to Violate Criminal or Tort Statutes Are Not Enforceable

Courts will not enforce agreements to commit crimes or torts (non-contractual civil wrongs). Crimes are defined by statutes. In civil law

jurisdictions, all civil wrongs are also defined by statutes. Common law jurisdictions may define some kinds of torts in statutes, and define the rest in court precedent.

(1) Crimes

Courts will not enforce agreements to commit or assist with crimes. Later, this Chapter will discuss a few important specific kinds of agreements that often violate criminal statutes, such as gambling agreements. But for now it is important to know this general rule.

For example, in Case Study 15 in Chapter 1 ("Basic Aspects of Contract Law"), two persons agreed to commit a robbery. This agreement was unenforceable, since robbery violates criminal laws. Courts will not enforce such agreements because it would probably encourage or even assist with the commission of crimes!

In addition, courts generally will not even award restitution of what parties have provided under such agreements. Courts do not wish to be involved in criminal activities even in that respect. So a party who transfers something under an illegal agreement to another party to that agreement generally cannot even recover what he has transferred!

*** ***CASE STUDY 116***

FACTS Dara works as a night security guard at a bank. Narith says he will give Dara $300 if Dara promises not to lock a back door leading to the bank vaults on a certain night. Dara agrees and takes Narith's money.

However, on the night of the planned robbery, Narith discovers that the door is locked and that he cannot get into the bank! Now Narith wants the court to enforce his agreement with Dara, and at least order Dara to return the $300.

QUESTION OF LAW Is the agreement between Dara and Narith enforceable?

DECISION No. The agreement to leave the bank door open was an agreement to assist with a crime, and so the agreement is illegal and unenforceable.

Courts will not enforce agreements to commit or assist with crimes. In this case, Dara's agreement to assist in the robbery of the bank was an agreement to assist with a crime (the robbery). Therefore, a court will not enforce the agreement. In addition, the court will not order Dara to return the $300 to Narith--even though Dara never performed his part of the agreement and Narith did perform his part.

Another important type of agreement that violates criminal statutes is an agreement to sell prohibited articles, such as illegal drugs or weapons. Where parties agree to sell articles prohibited by law, the court will not enforce the agreement.

*** ***CASE STUDY 117***

FACTS Keary felt unhappy. So she went to a local drug dealer to buy some opium, even though it was a crime to buy or sell opium in her jurisdiction. The drug dealer sold Keary some opium. Keary took the drugs, but decided they were of poor quality. So she went to the drug dealer to demand part of her money back.

QUESTION OF LAW Can Keary enforce this agreement against the drug dealer?

DECISION No. Keary's agreement is void and unenforceable because it is an agreement for the sale of opium, which is prohibited by a criminal statute.

Agreements for the sale of articles prohibited by criminal statutes are unenforceable. In this case, Keary and the drug dealer made an agreement for the sale of opium. But the sale of opium is prohibited by a criminal statute. Therefore, this is an illegal agreement that cannot be enforced, and Keary cannot recover any of her money.

One limit on this rule about prohibited articles is that some jurisdictions say that, where one party to an illegal agreement is significantly less "guilty" of wrongdoing than the other party, and the less guilty party has done nothing seriously wrong, that less guilty party can get restitution, under quasi-contract. For example, it is a crime in many jurisdictions to sell cigarettes or alcohol to a minor. If an agreement to sell such articles to a minor was made, it would be void, and even the minor could not enforce it. But the minor might be able to get restitution of what she had already paid, as the minor could under the rules about disaffirmance of voidable contracts explained in Chapter 4 ("Capacity"), Section 4.4a. That is because the minor might be viewed as significantly less guilty than the adult who tried to sell him the prohibited articles. This limit on the general rule will be further discussed in Section 5.5a, below.

*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity"), Section 4.4a contains further discussion of disaffirmance of voidable contracts by minors.

(2) Torts

Agreements to violate statutes that prohibit torts (non-contractual civil wrongs) are also void and unenforceable. In the civil law tradition, the rules about this kind of civil wrong are found in statutes.

In the common law tradition, torts are generally governed by court precedent, although some torts may be governed by statute. Court precedent is one source of public policy. In this Chapter, we will discuss in detail the legality of agreements to commit torts in Section 5.4, which is about agreements that violate public policy. But the status of such agreements is similar whether they are prohibited by statutes or public policy.

5.3b Many Gambling Agreements Are Not Enforceable

In many jurisdictions, courts generally will not enforce gambling agreements. Jurisdictions often prohibit or at least regulate gambling through statutes. This is because, though gambling may be popular, it is often considered to be a dangerous activity.

It appears that some jurisdictions will enforce gambling agreements where the gambling itself is legal. However, it appears that other jurisdictions refuse to enforce gambling agreements even if the gambling is allowed! Of course, that kind of refusal by the courts would be on the basis of public policy, since no statute in such jurisdictions prohibits the gambling. However, for convenience, we will discuss gambling agreements in some detail in this Section, rather than discuss them again in Section 5.4, which is about public policy.

Gambling can take many forms. These include bets on sporting events, lotteries, casino gambling, and bets on other future events. Perhaps because of this variety, gambling is hard to define. The following is an attempt to do so.

*** **DEFINITION:** A **gambling agreement** is an agreement in which parties stand to win or lose some consideration based on the occurrence of some future event over which they do not have complete control, and which therefore contains an element of chance.

In some jurisdictions, courts will enforce certain special types of legal gambling agreements. In France and England, for instance, it appears that horse racing can give rise to legal gambling contracts. In addition, many jurisdictions have lotteries which create legal gambling contracts. In these situations, the government usually receives revenue from these activities, and uses the revenue to further the public welfare, like tax money. In this way, nations try to use a potentially dangerous activity in a way that benefits the public.

In addition, many other enforceable agreements may appear to contain an element of gambling. In these legal agreements, parties may gain or lose some consideration based on the occurrence of events they do not control. For example, insurance agreements are based on the unknown outcomes of future events the parties do not control, such as accidental fires. And many modern financial transactions, such as derivative transactions, are based on unknown future events in various markets. These types of transactions are

generally enforceable. If they were considered to be "gambling," then they would be exceptions to the general rule that gambling agreements cannot be enforced. The law appears to believe the element of social benefit in these transactions outweighs the harm of the gambling element.

*** ***WHY IS THIS IMPORTANT?*** Why do many free market jurisdictions prohibit gambling, and say gambling agreements are not enforceable?

Most jurisdictions do not wish to encourage gambling agreements. There are a number of reasons for this. First, many persons appear to view gambling as an immoral way to make money. This may be because the money does not seem to be earned primarily through labor or merit, but instead through chance or luck.

In addition, although gamblers are encouraged to think they have a good chance to win, it appears that most gamblers lose more money than they win. The reason is that many parties involved in gambling, such as casinos, are very sophisticated. Usually, these parties have already calculated the chances of winning--and made sure that eventually the average gambler will lose and the sophisticated gambler will win! Some say this can harm society. Some people are desperate to escape poverty, and they may lose what little money they have by gambling. Others may become addicted to gambling, which can also lead to financial losses. This can also hurt family relationships.

Moreover, gambling in many forms has long been associated with crime. Indeed, some casinos have been used to launder money from crimes, such as extortion or drug dealing. So in some cases money made from gambling may actually be tainted by crime. And some of those who benefit from the activity may be criminals.

On the other hand, it may be argued that when courts refuse to enforce gambling agreements, it actually encourages gambling creditors to try to enforce such debts in other ways--such as violence or blackmail. Organized gambling also creates jobs in casinos and other gambling organizations, and may assist development to some extent.

In addition, governments can gain funds from legal gambling. Taxes on gambling institutions like casinos increase government revenue. In fact, governments may actually arrange organized gambling to raise revenue, such as through government-run lotteries.

So societies usually try to balance the potential benefits of gambling with the potential harm. But the result is that most free market jurisdictions do not encourage most forms of gambling. If governments do allow gambling, it is usually only in limited situations. And governments often regulate such gambling heavily, in order to control possible criminal activity.

*** ***CASE STUDY 118***

FACTS Thim is a cyclo driver. After work, he relaxes with colleagues by playing cards for money. All the players agree that they will pay any debts they incur, although this kind of gambling is prohibited by a statute in their jurisdiction. Last week, Thim was very lucky and now his three gambling partners owe him 17,000 riels. However, none of them wants to pay his debts.

QUESTION OF LAW Can Thim enforce his agreement in court?

DECISION No. Thim's agreement with the other gamblers is void and cannot be enforced.

In many jurisdictions, gambling agreements are not enforceable. In this case, the agreement Thim made with the other card players was a gambling agreement. The agreement was illegal under a statute. So Thim cannot enforce it, and cannot collect the 17,000 riels.

Sometimes people bet about the occurrence of other future events. Such gambling agreements may also be unenforceable.

*** ***CASE STUDY 119***

FACTS Sarakhan and Narong were farmers in the northwest. One evening, Sarakhan told Narong that Sarakhan believed his rice harvest would be larger than Narong's harvest. They decided to bet about Sarakhan's rice yield. They agreed that if Sarakhan's harvest yielded less than 13 tons, then Sarakhan would pay Narong 50,000 riels. However, if Sarakhan's harvest was 13 tons or more, then Narong would pay Sarakhan 50,000 riels. This kind of gambling agreement was illegal in this jurisdiction.

The rainy season that year was poor, and both men's crops suffered from a drought. Sarakhan's rice harvest yielded only 10 tons. When Narong went to claim his 50,000 riels from Sarakhan, Sarakhan said: "Sorry, Narong, but this drought has hit me very hard, and I cannot afford to pay you." But Narong had also been hurt by the drought, and he asked the court to enforce the agreement.

QUESTION OF LAW Will the court enforce Narong's agreement with Sarakhan?

DECISION No. The agreement about the outcome of Sarakhan's rice harvest is an illegal gambling agreement.

In many jurisdictions, gambling agreements generally cannot be enforced. In this case, the agreement Sarakhan made about the rice yield was a gambling agreement, because the parties were to win or lose money based on the outcome of a future event over which they did not have control.

This agreement was illegal under a statute. Therefore, the agreement cannot be enforced. The court will not order Sarakhan to pay Narong the 50,000 riels.

In some jurisdictions, loans made to enable someone to gamble are not considered gambling agreements, so it appears they can be enforced. For example, if Chhieng lends Rotana 5,000 riels so Rotana can continue gambling with him, that is not a gambling agreement. The reason seems to be that the loan is considered to be separate from the gambling. However, it could be argued that such a loan agreement promotes immorality (gambling), as discussed in Section 5.4h below, and that it should not be enforced for that reason. And it appears that other jurisdictions will not enforce such loan agreements.

5.3c Usurious Loan Agreements Are Not Enforceable Beyond the Legal Interest Rate

In most free market jurisdictions, loans with interest are generally legal. However, loan agreements are illegal if the rate of interest charged is higher than the rate allowed by the law of the jurisdiction. Such agreements are called usurious agreements. They are generally not enforceable beyond the legal rate.

In addition to repaying the money loaned, debtors are often required by the loan agreement to pay creditors an extra sum of money called interest. Interest is usually a certain percentage of the money loaned, although it may be expressed in other ways. So if 100 riels is loaned at 10% interest, then the debtor will have to repay the creditor 110 riels. The interest is like a fee to compensate the creditor for having lent some of his money to the debtor, instead of putting it to some other use.

*** **DEFINITION:** A **usurious agreement** is a loan agreement in which the amount of interest charged is higher than the rate allowed by law.

Usury laws forbid the lender to charge more than a certain interest rate. The actual limits on interest vary greatly. In fact, many Muslim nations forbid lenders to charge any interest, although it appears such nations may have other ways to structure loan contracts in order to compensate lenders. In addition, many jurisdictions have different limits for different types of transactions, and many say the limits do not apply to loans to corporations. In general, usury statutes are intended to protect the individual borrower from excessive interest.

One problem which may occur in calculating interest is how the percentage rate is calculated over time. It is necessary to know this in order to know how much interest is really being charged. Usury statutes specify the highest rate that can be charged for a certain time period, such as "20% per year." And usually the interest rate part of an agreement will also show this. For example, an agreement may say "interest at 5% per year," which would

mean that a principal of 100 riels would accrue 5 riels in interest at the end of one year. But if the agreement said "5% interest per month," then a 100 riels principal would accrue 5 riels each month--or 60 riels per year (5 riels x 12 months). This would be the same as 60% interest per year!

In addition, for some loans, compound interest is charged. This is really interest upon interest. It means that, at a specified time, the accrued interest is added to the principal sum. The total result is treated as a new principal for the calculation of the interest for the next period. For example, a loan of 100 riels at 5% interest per month, compounded monthly, would mean that at the end of the first month, the new principal would become the original 100 riels plus the 5 riels in interest that had accrued over that first month. So at the end of the first month, the new principal would be 105 riels. At the end of the second month, the debtor would owe a principal of 105 riels plus 5% interest on that 105 riels--a total of 110.25 riels. The effect of the compounding may be small at first, but over time it makes the total amount owed grow much larger.

The effect of a usurious loan agreement is different in different jurisdictions. The statutes that define the maximum interest rate generally say that any higher rate is illegal and cannot be enforced. For example, a statute may say that no loan agreement may charge over 5% per year in interest. This means that any rate over 5% is illegal, and a court will not enforce a loan agreement beyond that rate, no matter what the agreement says. Many jurisdictions will enforce a usurious loan agreement as if it charged interest at the statutory limit. For example, if a loan agreement charged 10% interest, but 5% was the maximum allowed by law, these courts would enforce the contract as if it said 5%! Of course, these courts would also order the lender to return any amount of interest already paid that is higher than the legal rate. Other jurisdictions say that usurious agreements are enforceable, but only to the extent that the borrower must repay the principal. In other words, the lender cannot recover any interest, as a penalty for charging an illegal rate. And other jurisdictions will not enforce such agreements at all, and not even allow the lender to recover any principal still owed by the debtor!

******* ***CASE STUDY 120***

FACTS Bora and Sarith lived in a jurisdiction where a statute said 20% per year was the maximum rate of interest that could be charged on loans, with a few exceptions. Bora borrowed $100 from Sarith, with 10% interest to be repaid with the principal in three months. This meant that, at the end of the three months, Bora would owe Sarith $110.

However, when it was time for Bora to repay the loan, Bora gave Sarith only $105. Bora said he found out that the legal rate of interest was 20% per year, and so he was not obligated to pay Sarith any more than $105.

QUESTION OF LAW Can Sarith recover the remaining $5 from Bora?

DECISION No. The loan agreement between Bora and Sarith charged a usurious rate of interest, and it is not enforceable at that rate.

Lenders can recover no more than the legal rate of interest on their loans. In this case, the loan agreement between Sarith and Bora did not seem usurious, because 10% is less than the 20% legal limit on interest. But that 10% rate was only for three months. In reality, the interest rate on Bora's loan was 40% per year--because if the loan period had been for one year instead of three months, the 10% per three months interest rate would have resulted in 40% per year! The highest rate allowed in this jurisdiction is 20% per year, or 5% per three months. Five per cent of $100 is $5. So in this case, Sarith cannot recover more than $105 from Bora.

In many jurisdictions, courts will enforce agreements like this at the legal rate (in this case 20% per year). Other jurisdictions might enforce the agreement but allow no interest to be charged, or refuse to enforce the agreement at all.

Some usurious agreements are disguised by money lenders in the hope that the borrower or the courts will not be able to tell that they are usurious. And sometimes this is hard for courts to detect, because there are so many ways to do it! Examples of ways to disguise usurious agreements include requiring the borrower to sell the lender something at a price below its market value; to buy something from the lender at a price higher than its real value; or to antedate the loan agreement--to state that the borrower received the money earlier than he actually did--so it looks like the interest is being charged for a longer period than it really is. These methods are usurious if the real effect is that the borrower must pay more interest than the law allows. Of course, to find out whether that is happening, courts must look carefully at all the facts surrounding the loan agreement.

5.3d Certain Agreements Made by Those Who Have Violated Regulatory Licensing Statutes Are Not Enforceable

When persons or businesses fail to comply with licensing statutes that apply to their work, and then make agreements as part of that work, those agreements may not be enforceable. For example, a government body may require that veterinarians get a license in order to practice. When parties who fail to meet such requirements make business agreements, the general rule is that they cannot enforce agreements made after they have violated statutes that mainly protect the public's health or welfare. But they can enforce agreements made after they violate statutes that mainly raise money for the government.

*** **DEFINITION:** A **licensing statute** is a statute which requires that some competent authority (generally a government body) formally give permission--a license--in order for someone to do something.

Often, such statutes require licenses for persons to do certain business activities or professions. In general, licensing statutes are divided into two categories:

(1) regulatory statutes that mainly protect the public's health or general welfare; and

(2) revenue statutes that mainly raise revenue for the government.

These two categories are discussed below.

(1) Regulatory statutes primarily protect the public's health, safety, or general welfare. Licensing requirements in regulatory statutes usually say that certain types of workers must meet certain standards of competence before they are permitted to do their work. Examples of such workers include: nurses, doctors, dentists, lawyers, builders, architects and public accountants. Courts will not enforce an agreement for such work made by a party who has broken a regulatory requirement. If such persons have no licenses, it appears that they cannot collect fees for their services. In fact, they may even be guilty of crimes!

*** ***CASE STUDY 121***

FACTS Tech studied architecture at university. However, he failed his qualifying examinations. So he did not become legally licensed to practice as an architect. Nevertheless, he opened an office in Phnom Penh.

One day, Sophea asked Tech to draw up plans for a new mansion in Prey Veng province. They signed an agreement under which Tech charged Sophea a $500 fee. But after Tech did the work, Sophea refused to pay the fee.

QUESTION OF LAW Would a court enforce Tech's agreement with Sophea?

DECISION No, in many jurisdictions. Tech will not be able to recover his $500 fee from Sophea, because he is not licensed as an architect.

In many jurisdictions, courts will not enforce professional agreements where the professional has failed to get the license required by law for him to practice. In this case, Tech failed to get the architect's license required by law. So he cannot enforce his agreement with Sophea. And this is true no matter how good a job Tech has done!

*** ***WHY IS THIS IMPORTANT?*** Why do many jurisdictions say that unlicensed workers cannot enforce agreements with their clients?

Although this rule may seem harsh, there are several possible reasons for it. Professional licenses are usually given only to persons who have shown they meet a certain standard of competence. Often that competence

is measured through difficult qualifying examinations. An unqualified professional (like an unqualified architect) could make a mistake that would cost lives. This rule tries to deter unqualified persons from posing as skilled workers, and possibly harming the public.

Of course, qualified persons are not perfect, and they also can make mistakes. But at least their qualifications prove that they are able to achieve a certain standard. Moreover, skilled workers are sometimes required to be insured. If something does go wrong, anyone harmed may be more likely to get compensation. Unlicensed workers may be less likely to have such "safety nets."

(2) Revenue statutes impose requirements primarily as a means of raising money for the government, and not as a way to assure competence. A party who has violated a revenue-raising statute--such as by failing to get a license not related to qualifications, or failing to pay a fee--may still enforce a contract for his work.

For example, if a market stall holder forgets to pay his annual registration fee to the government, he can still enforce his business contracts, such as contracts to sell fruit or get supplies. The reason is that such revenue statutes do not relate to competence. So there is less harm to the general public than with regulatory statutes. A vegetable seller is generally just as capable of selling a tomato whether he has paid such a fee or not. And the same would be true of a licensed architect who forgets to pay an annual license renewal fee, since that does not relate to competence. The only potential harm to the public in these situations is that the government has lost some tax revenue. Of course, the stall holder or architect may still be required to pay some penalty to the government for failing to pay the fee.

5.3e Agreements That Unreasonably Restrain Trade Are Generally Not Enforceable

Agreements that unreasonably restrain trade are generally void and unenforceable in many free market jurisdictions. Many jurisdictions have statutes that forbid unreasonable restraints of trade. Agreements that unreasonably restrain trade may also be unenforceable because they violate public policy, even if they do not violate a specific statute. Such agreements will be discussed in Section 5.4f, below.

***** DEFINITION: Agreements that unreasonably restrain trade** are basically those that harm competition or unreasonably restrict a party's freedom to conduct his trade or business as he chooses.

Of course, this is a very general definition. The exact definition depends on the actual statutes in each jurisdiction.

Generally, restraint of trade means restricting the freedom of a person or business to conduct a trade or business. In a way, all business agreements restrain trade to some extent, because they require the parties to do something, and so limit their freedom.

However, agreements that unreasonably restrain trade conflict with the goals of free market jurisdictions to encourage competition and promote efficient economic activity. This is because, if competitors are "free" to make contracts that actually hurt competition, there will eventually be less "free trade" in the entire market! So the courts and legislators of many jurisdictions look carefully at agreements to make sure they do not unreasonably restrain trade. For instance, an agreement to allow only one brand of computer into a nation would eliminate competition in that nation. Such an agreement would probably restrain trade unreasonably, and be unenforceable, in many jurisdictions.

However, it is important to remember that free market law does not protect individual competitors--only competition. So if a particular competitor loses business--or even loses his entire business--because of fair competition, the laws about trade restraints do not protect him.

Agreements that "unreasonably restrain trade" may take many forms, and this area of law can be very complex. Therefore, we will only discuss a few important types of trade restraints briefly and in a general way. Depending on local law, some types of such agreements are always unenforceable, while others might be unenforceable only in certain situations.

(1) Agreements to Fix Prices -- Agreements to fix (or set) prices so that prices of products will be the same among different competitors are often unreasonable restraints of trade. The reason is that such agreements may cause consumers to lose the benefits of free market competition. When competitors fix prices, the prices are usually unreasonably high. If the price fixers are an important part of the market, consumers may be forced to pay the high prices, because they may have few other choices. So there is less competition about price--which usually means high prices--and less choice for the consumer.

An example of a price fixing agreement would be if the two main bicycle manufacturers in a nation agreed to charge the same high prices for their bicycles, in order to increase the profits they made on each bicycle. If there were few other bicycles for consumers to buy, competition and choice would decrease, and consumers would be forced to pay too much for these products. So such an agreement might be an unreasonable restraint of trade.

(2) Agreements to Divide Territory and Exclude Competitors -- Other agreements to unreasonably restrain trade may divide the territory of a given market among sellers and exclude competitors. This also hurts competition and can encourage a monopoly. Very basically, a monopoly occurs where

one firm is the dominant seller of a particular product or service in a particular market. This may enable the firm to charge high prices for low quality products and exclude competition. In such cases, where consumer choice is restricted, there is less incentive for prices to be reasonable and quality to be good. So consumers may suffer.

*** ***CASE STUDY 122***

FACTS Yummy and Scrummy, the two dominant manufacturers of instant noodle soup in a particular nation, agreed to divide that nation's soup market. They agreed that Yummy would distribute his soup only in the east and north of the nation, and Scrummy would distribute his soup only in the west and south. They also agreed to use their market power to keep all other competitors out of the market. A statute in the nation prohibited unreasonable restraints of trade.

One day, Yummy went to visit his aunt in the north of the country. She told Yummy that one of her few pleasures in life was her daily bowl of Spicy Snake soup. Yummy told her that his firm did not manufacture Spicy Snake soup. His aunt showed him a packet of Scrummy Spicy Snake soup that she had bought at the local market. When Yummy saw his competitor's product, he became very angry. He went to the market and found that almost every stall holder was selling Scrummy soup products. Yummy now had proof that Scrummy's products were being sold in the north--a violation of their agreement. Yummy rang his lawyer that evening and asked him to prepare a case against Scrummy.

QUESTION OF LAW Is the agreement between Yummy and Scrummy enforceable?

DECISION No. The agreement between Yummy and Scrummy to divide the national soup market would probably be illegal and unenforceable because it unreasonably restrains trade.

In many jurisdictions, statutes prohibit unreasonable restraints of trade, including agreements to divide territory and exclude competition. In this case, Yummy and Scrummy divided their nation's territory and agreed to keep other competitors out. By making this agreement, Yummy and Scrummy prevented consumers from benefiting from a wide choice of soup products--and from competition in general. Under this arrangement, the two soup manufacturers would also be able to fix the prices of the soup products. That would probably mean the prices would be unreasonably high. This agreement is probably an unreasonable restraint of trade, which is prohibited in this jurisdiction. So it is probably unenforceable.

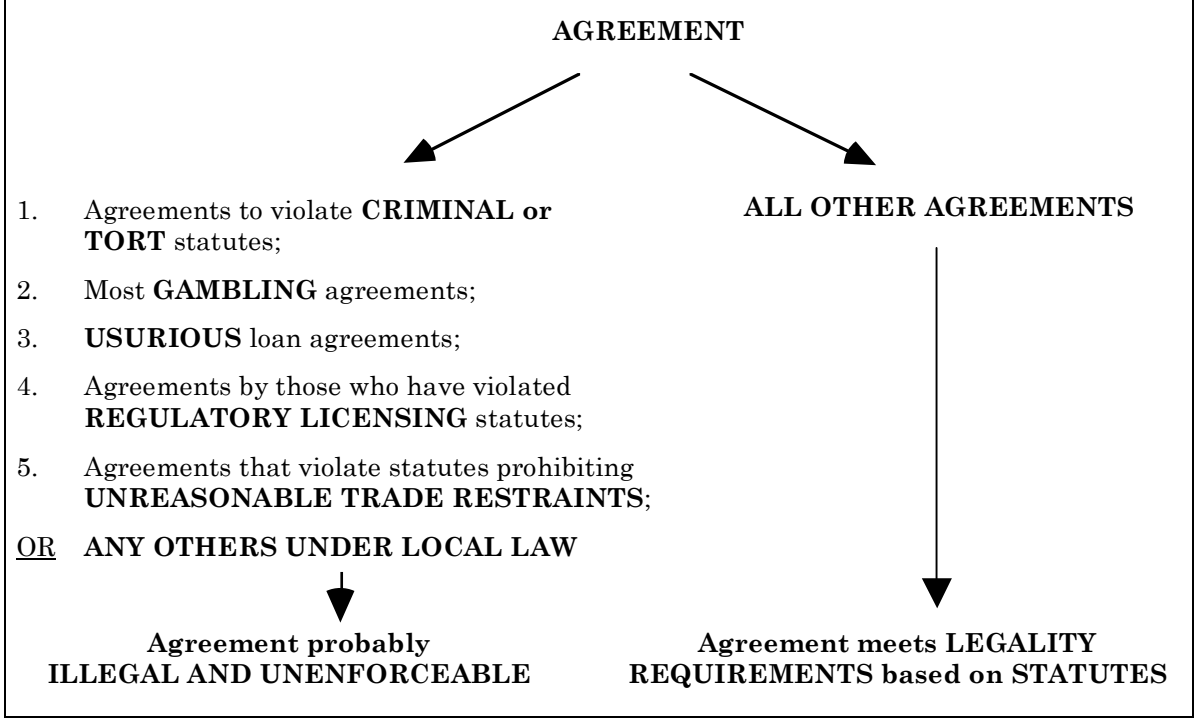
(3) Agreements to Limit Production -- Another type of agreement which might unreasonably restrain trade is one that would limit production of a certain product. For instance, two bicycle manufacturers might agree

to produce only 50% of their normal output, in order to make bicycles more rare on the market, and so allow them to charge higher prices. In this situation, the bicycle makers might make greater profits on each bicycle sold. But consumers would suffer. This is because if the supply of bicycles is low, consumers may be willing to pay more for a bicycle. So a manufacturer might make more profit on the sale of one bicycle at a high price than he would if he sold two bicycles at a more competitive price! This kind of agreement would restrict free trade, and prevent normal economic forces from giving consumers a variety of quality goods at reasonable prices.

5.3f Summary of Some Basic Rules about Agreements Prohibited by Statutes

As discussed above in Sections 5.3a-e, many types of agreements are prohibited by statutes, and so are generally unenforceable, in many free market jurisdictions. The chart below summarizes some basic rules about such agreements.

Illustration: Some Basic Rules about Agreements Prohibited by Statute



5.4 Agreements Contrary to Public Policy Are Generally Unenforceable

Many jurisdictions say agreements in limited situations are illegal and unenforceable, even though no specific statute forbids them, because

they violate "public policy." Public policy is difficult to define, but it basically means the good of society.

In some jurisdictions, especially civil law jurisdictions, agreements that violate public policy actually violate statutes--general statutes that simply prohibit any agreements violating "public policy," or "public order," as is the case in France. In common law jurisdictions, such agreements may violate rules about public policy developed in court decisions. Whether such agreements are prohibited by "public policy" statutes, or by rules about public policy developed in court decisions, courts in many free market jurisdictions will not enforce them.

This Section discusses agreements that may violate public policy. Section 5.4a explains in more detail what public policy is. The remaining Sections discuss some particular kinds of agreements that may violate public policy.

5.4a Public Policy Is Basically the Promotion of the Good of Society

The law tries to promote the good of society and avoid harming it. In contract law, this generally means that courts will not enforce an agreement if its effect would be contrary to the good of society.

*** **DEFINITION:** Very generally, **public policy** is the promotion of the common good and well-being of society.

Courts refuse to enforce agreements because of public policy only in limited situations. Public policy must be clear and widely recognized in a jurisdiction for a court to refuse to enforce an agreement on that basis. Perhaps the most reliable way to determine public policy is through the statutes and other activities of the legislative branch of government. Court decisions and executive branch actions are also important sources of public policy. Public policy can sometimes be measured in other ways, such as the acts of religious figures, scholars, or public interest groups.

As noted above, public policy is very difficult to define. It may change from one jurisdiction to the next, and from one generation to the next. However, public policy does not develop quickly. This is because it takes time for a new idea of the common good to be accepted by society, and to appear in legislation, court decisions, or other sources of public policy. And what one jurisdiction or generation considers to be the common good may not be true of another jurisdiction or generation.

For example, in some jurisdictions, it was for a long time considered contrary to public policy for legislatures or courts to recognize certain rights of unmarried couples who lived together in long-term unions, particularly homosexual couples. This was because such activity was considered immoral.

Now many unmarried couples live together, and it has become more accepted in some jurisdictions. So legislatures and courts in such jurisdictions may now recognize certain rights of such couples. That indicates that public policy in those jurisdictions has changed to some extent. Of course, other jurisdictions may not agree.

*** ***WHY IS THIS IMPORTANT?*** Why do some courts refuse to enforce certain agreements on the basis of "public policy," even though no specific statute prohibits those particular agreements?

When courts refuse to enforce agreements on the basis of "public policy," it may appear to conflict with the idea of freedom of contract. Some might argue that courts should only refuse to enforce agreements when the legislature has indicated, through a specific statute, that that kind of agreement should not be enforced. In addition, it might be argued that "public policy" is a vague idea, and it might give courts too much discretion to refuse to enforce agreements they do not like. This might also harm "the rule of law." People may not agree about what the rule of law means. Basically, many consider it to be the idea that law should be applied fairly and consistently, based on well understood rules--not based on the personal feelings or arbitrary decisions of powerful officials or judges. Some believe the "rule of law" can exist even where legal rules do not reflect the will of the people, since arguably even a dictator can enforce his rules fairly and consistently. Others say that if even a "fair dictator" can change the rules without the people's consent, then it is still that dictator who rules--not the law. In any case, these are legitimate concerns, and courts that apply the "public policy" rules may have problems because of them.

On the other hand, in jurisdictions where courts refuse to enforce contracts because of public policy, it appears that the courts are trying to remain flexible enough to handle situations the legislature may not have envisioned, or may not have addressed clearly. For example, if two parties agree to start a prostitution agency, that agreement would probably be viewed as against public policy by courts in many societies. And it might be against public policy for a company to agree to dispose of dangerous chemical waste by dumping it on the ground in a populous area. Agreements like that might be void and unenforceable--even if the legislature had passed no statute specifically forbidding such activities. Of course, in many jurisdictions, there is at least some legislation indicating that prostitution and pollution are against public policy. And in common law jurisdictions, there is a long tradition of the development of legal rules through court decisions, where legislation does not exist or is not clear in a particular legal area. The idea is that courts should carefully supplement the legislature's role in promoting the rule of law--not create uncertainty, or violate the will of the legislature, or harm the legitimate intentions of the parties.

In deciding whether to refuse to enforce an agreement because of public policy, courts try to balance the interests of parties to a contract against the

interests of society as a whole. When the interests of society in not having the agreement enforced outweigh those of the parties in having the agreement enforced, the courts may refuse to enforce the agreement based on public policy. It is also important to remember that such situations are rare. They only occur when it is clear that the agreement is harmful to the good of society.

There are several types of agreements which are considered to be contrary to public policy in many jurisdictions. We will discuss seven types of such agreements, though there may be others in different jurisdictions. The seven we will discuss are agreements which:

(1) involve the commission of torts;
(2) harm the freedom of marriage;
(3) harm the administration of justice;
(4) harm public service or interfere in public affairs;
(5) unreasonably restrain trade;
(6) promote immorality; or
(7) contain improper exculpatory clauses.

These types of agreements are discussed in the following Sections.

5.4b Agreements to Commit Torts Are Not Enforceable

Courts will not enforce agreements to commit torts, because enforcing such agreements would be contrary to public policy. For example, common law courts will not enforce an agreement between private parties to falsely imprison someone, even if no statute prohibits it, because this is a tort under rules developed by courts. As explained in Section 5.3a above, courts will also not enforce agreements to commit torts defined by statute.

*** **DEFINITION:** A **tort** is basically a non-contractual civil wrong for which the wronged party--not society--can seek compensation.

Some torts are also crimes. But the basic difference is that tort lawsuits are brought by private parties, whereas criminal actions are brought by the government on behalf of society.

In common law jurisdictions, torts are primarily defined by legal rules developed by courts, although some torts are defined by statutes. So even where no statute specifically prohibits such wrongs, courts will not enforce agreements to commit them. The reason for this rule is that if courts enforced such agreements, it might encourage parties to commit torts--and actually involve the courts in committing the wrongs!

*** ***CASE STUDY 123***

FACTS Puth decides he wants to destroy the reputation of a certain politician who has said things Puth dislikes. So Puth and Sarvy agree that Puth will pay Sarvy $10,000 to publish an article in her newspaper which falsely accuses the politician of doing specific acts which are treasonous.

However, just before the date for publication, Sarvy decides that it would be wrong to publish these false statements. So she refuses to publish them. Puth asks the court to enforce the agreement.

QUESTION OF LAW Can Puth enforce his agreement with Sarvy?

DECISION No. Puth cannot enforce this agreement because it is an agreement to commit a tort: defamation.

Courts will not enforce agreements to commit torts, even where no statute specifically prohibits them, as often occurs in common law jurisdictions. In this case, Puth and Sarvy agreed to defame a politician by publishing harmful statements about that person which they knew were false. This is not a crime in most jurisdictions, but it is a tort or civil wrong. Therefore, Puth cannot enforce the agreement.

5.4c Agreements That Harm the Freedom of Marriage Are Not Enforceable

In many jurisdictions, agreements which harm the freedom of marriage are not enforceable because they violate public policy. Most jurisdictions want to encourage good marriages, and maintain what many view as their sacred nature. In order to promote good marriages, many jurisdictions wish to protect the individual's right to freely choose who the individual will marry, and to protect that choice after the marriage occurs. So many agreements that interfere with those rights are unenforceable. Some jurisdictions also have statutes that protect the freedom of marriage.

Several types of agreements are unenforceable in many jurisdictions because they harm the freedom of marriage. Three of these types are discussed below.

(1) Agreements to Marry -- Many jurisdictions will not enforce agreements to marry, or at least will not order the parties to marry each other. In Australia and England, for example, courts will no longer enforce promises to marry. In the past, agreements to marry were valid contracts in many jurisdictions. This may have been because such agreements were like commercial agreements, to some extent. But many jurisdictions will no longer enforce such agreements. This is an example of a change in public policy. It may seem odd that some courts now promote marriage by not enforcing agreements to marry! But many jurisdictions want to promote good, voluntary

marriages--not just any marriages. And in many jurisdictions, the freedom of marriage includes a person's freedom to change his mind before the marriage.

However, it also seems likely that a party could at least get restitution of what he had transferred to the other party because of a marriage agreement, under quasi-contract--as long as what was transferred was actually part of the marriage agreement, and not a gift. It also appears that some jurisdictions might compensate a party who changed his position in reliance on such a marriage agreement, such as by spending money to prepare for a wedding, even if the agreement is not enforceable. In that kind of situation, a court might consider awarding a party his reliance damages, under a theory of promissory estoppel. These potential remedies will be discussed in Section 5.5a, on the effect of illegal agreements.

*** ***CASE STUDY 124***

FACTS Bunny agreed to marry Samnang in exchange for his promise to marry her and give her one damlung of gold. Samnang gave her the gold, but on the day before the marriage, Bunny decided she did not wish to get married. Samnang asks the court for help.

QUESTION OF LAW Can Samnang enforce his agreement with Bunny?

DECISION Perhaps. Courts will not order Bunny to marry Samnang, but courts in some jurisdictions would order her to return the gold.

Many modern courts will not enforce marriage agreements, and those that will are likely to award only compensation--not order a marriage to occur. In this case, Bunny broke her marriage agreement with Samnang. Although courts in many jurisdictions would not enforce this agreement, some courts would order Bunny to provide restitution of the gold Samnang had given her under the agreement. It appears that some jurisdictions would say they were enforcing the agreement and awarding restitution damages to Samnang. Others might say they were not enforcing the agreement, but only giving Samnang restitution under quasi-contract.

In many jurisdictions, agreements to marry are also unenforceable when they are made by persons who are already married. The reason appears to be that, if such agreements were enforceable, it might lead to immorality or criminal activity. Such agreements probably weaken the existing marriage. They could also lead to bigamy--having more than one spouse at a time--which is illegal in most free market jurisdictions. And they might even lead to harm to the spouse who is not a party to the agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains further discussion of quasi-contract; Chapter 6 ("Formality"), Section 6.3d contains further discussion of agreements to marry and related formality requirements; Chapter 7 ("Other Contract Formation

Problems"), Section 7.8 contains further discussion of promissory estoppel; and Chapter 10 ("Remedies"), Section 10.4 contains further discussion of restitution.

(2) Agreements Not to Marry -- Agreements in which a party promises not to marry at all; not to marry particular persons; not to marry anyone except a particular person; or not to marry for a particular period of time are void in many jurisdictions. However, some jurisdictions say an agreement is not void if it deters marriage but does not prevent it. For example, under this rule, an agreement to live or work far away from a potential spouse might be enforceable, since it would deter marriage, but not prevent it.

*** ***CASE STUDY 125***

FACTS Colonel Monocle, leader of the Blue political party, has a 20-year-old daughter named Liberty. Liberty is madly in love with Freeman. However, Freeman's father is Koolman, leader of the Pink political party. Because the Blue Party dislikes the Pink Party, Colonel Monocle is horrified that his daughter loves Koolman's son. The Colonel wants Liberty to marry Vuth, the son of a friend of his.

The Colonel asks Liberty to agree not to marry anyone except Vuth. In return, the Colonel promises to buy her a stallion from the Hotblood Stud Farm. Liberty agrees. But after meeting Vuth, she decides she wants to marry Freeman.

QUESTION OF LAW Can the Colonel enforce his agreement with his daughter?

DECISION No. The Colonel's agreement with his daughter restricts the freedom of marriage, so it is void and unenforceable.

In many jurisdictions, agreements not to marry are generally unenforceable because they violate public policy. In this case, Liberty agreed not to marry anyone but Vuth. But Liberty is an adult who has the right to marry anyone she chooses. This agreement clearly restricts Liberty's right to do that. So the Colonel cannot enforce it.

(3) Marriage Brokerage Agreements -- Marriage brokerage agreements are void in many jurisdictions. These agreements occur where one party promises to find a spouse for another party in exchange for a fee. The reason these agreements are unenforceable in many jurisdictions is that it violates public policy in such jurisdictions for brokers to arrange marriages for money. The idea appears to be that such marriages may be more likely to prove unsuitable to one or both spouses, since the broker may be motivated--by money--to arrange a marriage as quickly as possible, whether it is good for the marrying parties or not.

5.4d Agreements That Harm the Administration of Justice Are Unenforceable

Agreements that harm the administration of justice are void and unenforceable. The administration of justice basically means the operation of the legal system. That generally includes the courts and those who enforce the laws, such as the police.

An example of an agreement that would be unenforceable because it would harm the administration of justice would be one in which a person agreed to pay money to a witness--or the judge--if that person won a lawsuit. Such an agreement would harm justice, because it would make it difficult for the court to base its decision solely on the relevant law and facts. This could cause an incorrect or unfair decision, instead of justice.

*** ***CASE STUDY 126***

FACTS In a criminal case, the prosecution alleges that Thrasher beat up Scrummy after finding part of a dead rat in his Scrummy brand soup. Scrummy has no memory of the beating because of his injuries. The prosecution says Huot was the only person who saw Thrasher beat up Scrummy, and that Huot will be called to appear in court as a witness.

However, Huot works for a rival soup manufacturer named Yummy. Yummy is happy that Scrummy was hurt. He does not want Thrasher to be found guilty at the trial. Yummy knows that if the prosecution has no witness to the beating, then it is likely that there will not be enough evidence to convict Thrasher. So Yummy tells Huot to take a holiday in Preah Vihear and not return until the trial is over, when Yummy will give Huot $100. Huot agrees and takes the holiday.

As the trial date approaches, the prosecution cannot find Huot. Thrasher is acquitted. But when Huot returns from Preah Vihear and asks Yummy for the $100, Yummy just laughs and tells him to get back to work.

QUESTION OF LAW Can Huot enforce his agreement with Yummy?

DECISION No. Huot's agreement with Yummy harms the administration of justice, so it is void and unenforceable, even if it does not violate a specific statute.

Agreements that harm the administration of justice are unenforceable. In this case, Huot and Yummy agreed that Huot would make himself unavailable to testify in the prosecution of Thrasher--even though they knew Huot would be an important witness! This kind of agreement harms the administration of justice, because it prevents the court from hearing all the evidence required to make a fair decision, based on all the relevant facts. So the agreement is contrary to public policy, and Huot cannot enforce it.

It also harms the administration of justice for a party to make an agreement to prevent those who enforce the law (such as the police) from enforcing it against that person. For example, if a business owner has evaded tax on his profits, and a tax inspector agrees not to prosecute him in return for a lifetime's supply of noodle soup, that agreement would be unenforceable. The reason is that it would prevent the law from being properly enforced, and so harm the administration of justice.

5.4e Agreements That Harm Public Service or Interfere in Public Affairs Are Not Enforceable

Agreements that harm public service or interfere in public affairs are void because they violate public policy. This is true under judicial rules in common law jurisdictions, and there may also be statutes that say so in both civil law jurisdictions and common law jurisdictions. These kinds of agreements harm the legitimate functions of government. So they harm the interests of the entire nation.

(1) Agreements That Harm Public Service (Official Corruption)

Agreements that harm public service are unenforceable. They are agreements under which a public official performs official acts on the basis of unauthorized compensation--bribes--instead of the best interests of his society. Such agreements are examples of official corruption. Two types of such corruption will be examined in this Section: general corruption and bidding corruption.

*** ***WHY IS THIS IMPORTANT?*** Why are agreements that harm public service unenforceable? Why is official corruption contrary to public policy?

The law will not enforce such agreements because official corruption can hurt a nation badly. When important public decisions are made on the basis of the personal profit of a few officials--instead of what is best for the entire society--those decisions are often bad ones which harm the nation. For example, awarding an important government contract to the bidder who has paid the largest bribe, instead of the best qualified bidder, can result in poor quality work. It may also be dangerous.

Official corruption can discourage investment. Most responsible investors want to rely on their business abilities and the rule of law. Most do not want to lose their investments because an official decides their bribe is not big enough, or that someone else can pay a bigger one. And most want to be able to enforce contracts based on the law.

Official corruption can also slow development in other ways. It robs the government of precious resources, but often provides no benefit to most people. This lack of resources can prevent advances in every area of public work,

including health care, education, law, public works, the environment, and national defense.

In addition, widespread official corruption can shatter the public's faith in the government. Ordinarily honest individuals may be unable to get what they deserve through merit or legal ways. So they too may be forced to use corrupt practices. In fact, there may be less motivation for most people to work hard at school or at a job if advancement is not related to merit. In the end, this may result in a lack of qualified and hard working persons to develop the nation. In addition, there may be little trust in the legal system. Court cases may be decided based on which party pays the larger bribe--not on law. So less wealthy people may be discouraged from trying to assert their rights.

Finally, official corruption can reward unqualified members of society with power and influence. The result is that persons with limited abilities may end up controlling important parts of society. When unqualified persons rule and qualified persons are excluded from power, the results can include poverty, poor health, ignorance and violence.

No nation is free from official corruption. But many nations recognize its bad effects and try to fight it. Of course, this can be difficult, because corruption may result from things that are hard to change, such as low government wages.

(1) General Corruption -- Agreements that involve paying bribes to public officials are unenforceable. Such agreements can take many forms. Examples include agreements to sell public jobs (such as paying money to become a ministry official), and agreements to obtain pardons or paroles (such as giving a new Mercedes to a prison official in return for a pardon of an imprisoned person). Some of these illegal agreements may also harm the administration of justice, as explained in Section 5.4d, above.

*** ***CASE STUDY 127***

FACTS Gummy is a food scientist who supervises the testing of soup products at the Ministry of Soup. Gummy is also the son of a soup magnate named Scrummy.

The Ministry has been testing the latest Scrummy product: Monkey Eye noodle soup. A junior technician named Sen finds that the soup contains an artificial substance which is prohibited by soup regulations because it may harm people. Sen submits a report recommending that the soup be banned from sale. Gummy tells his father Scrummy about the report. Scrummy asks Gummy to pay Sen to destroy the report and write a new one that approves the product.

Gummy and Sen agree that Gummy will pay Sen $5,000 to destroy the old report and submit the new one. Gummy pays Sen the $5,000. But the next

day, Sen refuses to write a new report--and sends the old one to the Minister and to the press! Gummy asks the court to enforce his agreement with Sen.

QUESTION OF LAW Can Gummy enforce his agreement with Sen?

DECISION No. The agreement between Gummy and Sen harms the public service, so it cannot be enforced.

Agreements of public officials to perform official acts in exchange for some consideration beyond their salaries are unenforceable. In this case, Gummy and Sen agreed that Sen would destroy his report about the illegal substance in Scrummy soup and write a new false one, in exchange for $5,000. This is an agreement of a public official to change official actions in exchange for money from a private source. So it is illegal and unenforceable. In fact, the agreement could harm public health. If the false report is published, and the Scrummy soup remains on the market, the soup might harm many people.

(2) Bidding Corruption -- Agreements that reflect bidding corruption are also unenforceable because they harm public service. In most jurisdictions, important government contracts to provide services and goods are bid upon by private companies. Examples include construction and telecommunications projects. Bidding corruption occurs when bidders give public officials money or other benefits in return for the contracts. Most free market jurisdictions believe that this kind of corruption harms society, leading to poor work, wasting government money, and even endangering people's lives.

*** ***CASE STUDY 128***

FACTS The Minister of Defense wants to make sure his soldiers get good rations. So he solicits bids for a contract to supply fifty million packets of instant noodle soup for the Army. By statute, the lowest viable bid will get the contract.

Two instant soup manufacturers named Yummy and Scrummy are the only viable bidders. Yummy's bid is for $4,000,000, and Scrummy's bid is for $6,000,000. After Scrummy's bid is submitted, he rings Pochin. Pochin works at the Defense Procurement Office and will be responsible for the final decision about who gets the soup contract. Scrummy asks Pochin to do his best to make sure Scrummy wins the contract. Pochin agrees, in return for Scrummy's promise of a $100,000 payment. Pochin complies with Scrummy's request, and Scrummy's $6,000,000 bid is accepted.

The next day, the Minister's security aide tells the Minister that she has discovered corruption at the Procurement office. The Minister rings Scrummy, and tells him the Ministry is canceling the contract. Scrummy threatens the Minister with a lawsuit, and refuses to give Pochin the $100,000 he had promised.

QUESTIONS OF LAW Can Pochin enforce his $100,000 agreement with Scrummy? Can Scrummy enforce his agreement with the Ministry?

DECISION No. The agreements are unenforceable by Pochin or Scrummy, because they harm public service. The agreement with Pochin violates public policy and possibly the bidding statute. The soup contract violates the bidding statute.

Agreements to obtain public contracts through bribes are unenforceable because they violate public policy. Here, Scrummy and Pochin agreed that Pochin would do his best to make sure Scrummy would get the soup contract, even though Scrummy's bid was higher than Yummy's, and the bidding statute required the contract to go to the lowest viable bidder. In return, Scrummy promised to give Pochin $100,000. This corrupt agreement cannot be enforced. It might violate the statute itself, depending on how the statute was written. But even if it did not violate the statute, it would not be enforceable because it violates public policy.

As noted above, statutes often require that public contracts be awarded to the lowest viable bidder. Here, the Ministry (because of the actions of Pochin) awarded the soup contract to Scrummy, who did not have the lowest viable bid. So the soup agreement violated the bidding statute, and Scrummy cannot enforce it.

(2) Agreements That Interfere in Public Affairs and Harm the National Interest

Agreements that interfere in public affairs and harm the national interest are unenforceable because they violate public policy. Public affairs are affairs of the government and other public institutions. The national interest is the well-being of the nation. An example of the national interest is the protection of national borders.

This Section will discuss two types of agreements that interfere in public affairs and harm the national interest: agreements which damage a nation's security, and agreements which harm relations with other nations. There are very few situations where courts refuse to enforce agreements on this basis, because few agreements really have such harmful effects. The law does not wish courts to act in this area unless the harm to the national interest is real and very serious.

(1) Agreements that damage a nation's security are unenforceable. For example, an unauthorized agreement to sell national secrets to a foreign government would generally damage a nation's security. In addition, it would generally harm a nation for its nationals to trade with another nation officially at war with the first nation. This rule might also apply to trade with a guerrilla group that is fighting to overthrow the government of a nation. Such agreements may actually help the enemy nation or group! In addition, it

may be immoral to profit by trading with an enemy while fellow citizens die in a war with that enemy. Such agreements, if made during a war, are illegal and unenforceable in many jurisdictions.

*** ***CASE STUDY 129***

FACTS Because of a border dispute, the neighboring countries Vadia and Gordia declared war on each other. Three days after the declarations of war, Chhay, a Gordian shoe manufacturer, signed a foreign export agreement with a Vadian distributor. Under the agreement, Chhay was to supply 20 container loads of boots to the Vadian distributor. However, the border between the two countries was sealed off, and the boots could not get through. The Vadian distributor threatened to sue Chhay for not performing the contract.

QUESTION OF LAW Can the Vadian distributor enforce this agreement?

DECISION No. The agreement would be unenforceable in many jurisdictions because it damages the security of Vadia and Gordia, harming the national interest.

Agreements that damage a nation's security are illegal and unenforceable. Although very few agreements actually do this, one example of agreements that generally do are those between the citizens of nations that are at war. In this case, Chhay and the Vadian distributor made an agreement after declarations of war between Vadia and Gordia. In many jurisdictions, this agreement would be considered interference in public affairs (a war). Courts believe that to enforce such an agreement would harm the national interest. So neither party could enforce the agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity"), Section 4.8 contains further discussion of the status of agreements made with "enemy" foreigners, which may also be void because the "enemy" foreigners lack capacity.

(2) Agreements that harm relations with other nations are also unenforceable. However, the harm must be very clear for a court to act here. The following Case Study shows the kind of situation where a court might do so.

*** ***CASE STUDY 130***

FACTS The nations of Bodia and Kaos have been friendly for decades. In fact, it is vital for Bodia's national security and development that it have good relations with Kaos.

Unfortunately, Kaos is having problems with the neighboring nation of Narnia, whose human rights problems are causing widespread unrest and a major refugee crisis. Kaos has imposed an economic embargo on Narnian

goods. The embargo says no Kaotians can do business with Narnians. And recently, Narnia's numerous violations of the Kaotian border have led Kaos to declare war on Narnia! The Bodian government assures the government of Kaos that it will do all it can to support Kaos, and that it will discourage trade and other contact between its citizens and those of Narnia. The Bodian National Assembly overwhelmingly endorses that policy.

However, a Bodian soup manufacturer named Scrummy continues to do business with a Narnian spice merchant called Narstee. Scrummy agrees to buy from Narstee a shipment of the rare spice kondimenta. Scrummy pays Narstee for the spice. However, Narstee fails to deliver the spice. Scrummy asks Narstee to refund the money he paid for the spices, but Narstee refuses. Scrummy asks a Bodian court for help.

QUESTION OF LAW Can Scrummy enforce the contract with Narstee in Bodia?

DECISION Perhaps not. Scrummy may not be able to enforce the agreement, because that might harm Bodia's relations with Kaos.

Agreements that harm relations with other nations are not enforceable because they harm the national interest. In this case, the agreement between Scrummy (a Bodian) and Narstee (a Narnian) to trade in Narnian goods (the spices) did not violate Kaos' embargo, which applied only to trade between Kaos and Narnia.

However, the agreement may harm Bodia's relations with Kaos. This is because it helps Narnia by providing it with trade--and money--at a time when Narnia is actually under embargo and at war with Bodia's important ally Kaos. That is contrary to clear Bodian government policy. So even though the agreement violates no Bodian statute, it may violate Bodian public policy. So it may not be enforceable.

However, this does not mean that a court may refuse to enforce contracts simply because it does not like a particular trader or nation! The court must consider the national interest only, as clearly expressed through sources of public policy, such as legislation or executive action. In Case Study 130, the Kaotian embargo and declaration of war, the importance of Kaos to Bodian national security, and the clear statements of the Bodian government and National Assembly may show that such a public policy existed in Bodia. But there are few situations where agreements would actually have this kind of serious effect on the national interest.

5.4f Agreements That Unreasonably Restrain Trade Are Not Enforceable

In many jurisdictions, agreements that unreasonably restrain trade are unenforceable even if they do not violate specific statutes, because

such agreements are contrary to public policy. As discussed above in Section 5.3e, many jurisdictions also have statutes that forbid unreasonable restraints of trade. In fact, even in many common law jurisdictions, most trade restraints are governed by statutes. But some restraints are not, and these may violate public policy. Trade restraints that violate public policy seem to be mostly ones that restrain individual parties from conducting their business or trade, rather than the more far-reaching types discussed earlier, such as agreements to fix prices or divide territory.

*** ***WHY IS THIS IMPORTANT?*** Why are agreements to unreasonably restrain trade unenforceable in many jurisdictions, even when the restraints do not violate specific statutes?

First, as discussed in Section 5.3e above, such agreements harm the public's interest in free competition. In addition, it is not in the public interest for a person or organization to be unreasonably restricted in conducting a lawful trade or business. For example, if a talented young engineer cannot work in a nation, that nation will lose the benefits of his skill and efforts, including passing on his skills to associates. Many nations believe that they work best when every person is free to do the work he does best. In addition, the engineer will not pay tax on his income as an engineer, so the state may lose revenue.

Moreover, the law seeks to protect the freedom of individual parties to work and trade as they wish. This freedom might be harmed if such parties were allowed to negotiate away the freedom to someone else who might be in a stronger bargaining position. For example, if a senior engineer makes his departing associate agree never to work as an engineer in Cambodia again, that restraint would probably be too broad to be enforced. It might prevent the person from working again in that field, and rob him of his livelihood.

A number of different kinds of agreements may unreasonably restrain trade and violate public policy. We will briefly discuss only two important types of such agreements: agreements not to compete, and exclusive dealing agreements.

(1) Agreements Not to Compete

Agreements not to compete are agreements in which someone promises that he will not engage in a certain business, in a certain geographical area, for a certain amount of time. This generally prevents the party making the promise from competing with the party receiving the promise.

In many jurisdictions, a promise not to compete is enforceable only if:

(1) restricting competition is not the main purpose of the agreement in which the promise is made;

AND (2) the restriction is reasonable as to time and place, based on the nature of the business and other circumstances.

In fact, some jurisdictions enforce such promises only if they are part of contracts for the sale of a business or employment contracts. And even in those situations, the promise cannot restrict a competitor for too long or in too large an area. If the restriction goes further than is necessary to protect the legitimate interests of the other party--further than is "reasonable"--then it is unenforceable.

Such promises may occur when a party buys an existing business. In that situation, the buyer is not only buying physical assets (such as a building), but also goodwill. Goodwill is the positive opinion of customers that can arise from an established and well-run business. In fact, goodwill can be the most valuable asset of a business! A buyer of a business can at least try to keep this asset by requiring the seller to promise not to compete. For instance, a restaurant owner who sells his business may agree that he will not open another new restaurant in the same area for a certain period. Otherwise, some of his old customers might simply go to his new restaurant! This could make business difficult for the buyer of the old restaurant.

Promises not to compete are also found in employment agreements.

*** ***CASE STUDY 131***

FACTS Sethik worked for Scrummy, a soup manufacturer, as a business development manager. When Sethik first started this work, he promised Scrummy as part of his employment contract that if he ever left Scrummy's employ, he would never work for the soup industry again anywhere. In his job, Sethik dealt with Scrummy's biggest customers, who got to know and like Sethik. After working for Scrummy for 15 years, Sethik quit.

Ten years later, Scrummy learned that Sethik had set up a soup factory in the neighboring country of Kaos. In fact, Sethik was selling to most of Scrummy's best customers, who liked Sethik's soups better! Scrummy asked the court for help.

QUESTION OF LAW Can Scrummy enforce this promise not to compete?

DECISION No. Sethik's promise not to compete with Scrummy is not reasonable as to time and area, so it is not enforceable.

In many jurisdictions, promises not to compete are enforceable only if restricting competition is not the main purpose of the agreement in which

the promise is made, and the restriction is reasonable as to time and place. In this case, Sethik's promise not to compete was part of his original employment contract, so restricting competition was not the main purpose of the agreement. However, the agreement also required that Sethik never work in the soup industry again anywhere! This kind of restraint as to time and area is not reasonable. It does more than protect Scrummy's legitimate interests--it eliminates a potential competitor forever. So it is unreasonable, and unenforceable.

The effects of unenforceable promises not to compete vary. It appears that some courts will not enforce them at all. Other courts will enforce such promises, but only to the extent of a reasonable restraint. For example, in Case Study 131 above, some courts might permit Scrummy to state a reasonable restriction, and if he could, they would enforce that. This situation is similar to the way some courts treat usurious loan agreements: they will enforce the usurious agreement, but only at the legal interest rate. In addition, if such a competition restraint was unenforceable but was only part of a larger agreement that could stand on its own--without the illegal clause--many courts would "sever" the clause and still enforce the rest of the agreement. This is explained in Section 5.5.

(2) Exclusive Dealing Agreements

Exclusive dealing agreements occur where independent parties agree that one or both of them will not trade goods or services with anyone else. Such agreements are unenforceable if they unreasonably restrain trade. Two situations where this can occur are service contracts and trading agreements.

(1) Exclusive Service Contracts -- A service contract is a contract between two independent parties in which one party agrees to perform some service for the other. It is not an employer-employee relationship, but a principal-independent contractor relationship. An independent contractor is one who agrees to do certain work but who is not subject to the control of his employer (the principal) except as to the result of the work. That is, unlike an employee, the contractor decides how the work is done.

Sometimes a principal may seek the exclusive services of an independent contractor. In many jurisdictions, this is a reasonable restraint (and enforceable) if the main purpose of the clause is to ensure that the contractor's services will be available to the principal. If the clause is not aimed at this goal, but at ensuring that no one else can get the services, then the clause is unreasonable.

******* ***CASE STUDY 132***

FACTS Sovenn, a contractor, provides special cleaning services and hygiene maintenance to the food industry. Scrummy makes instant soup. Scrummy and Sovenn make a service agreement under which Sovenn will

provide his services to Scrummy's two main soup plants but to no one else. This work takes Sovenn's firm 12 working days each month. The rest of the time, Sovenn's workforce is idle.

Yummy, a rival soup maker, asks Sovenn to provide his services at Yummy's factories. This would give Sovenn's workforce 8-10 more days of work each month, without interfering with Sovenn's work for Scrummy. Sovenn gladly accepts the offer. But when Scrummy learns about this agreement, he complains to the court.

QUESTION OF LAW Will a court enforce the exclusive services clause in Sovenn's contract with Scrummy?

DECISION No. The purpose of the exclusive services clause here appears to be to prevent anyone else from getting Sovenn's services, so it is not enforceable.

Exclusive services agreements are enforceable if the main purpose is to ensure the services are available to the party who receives the promise. In this case, it appears that the exclusive services clause between Scrummy and Sovenn was not intended mainly to ensure Sovenn's special cleaning services for Scrummy. Instead, it seems that it was intended to prevent anyone else from getting these services. In fact, Scrummy only needs Sovenn's services for 12 work days per month. So this is an unreasonable restraint, and it is not enforceable. It harms the free market and Sovenn, because it ensures no other food maker can get Sovenn's special services.

(2) Exclusive Trading Agreements -- Exclusive trading agreements may also unreasonably restrain trade. They occur where a party agrees to buy certain products from one seller only, or to sell to one buyer only. In fact, these are similar to output and requirements contracts, which were discussed in Chapter 3 ("Consideration"), Section 3.5d. For example, petrol companies often ask those who lease their service stations to agree not to buy petroleum products from anyone else.

Many jurisdictions say that such exclusive trading agreements are enforceable if they go no further than is necessary to protect the legitimate interests of the party receiving the promise. Examples of unenforceable restrictions vary in different jurisdictions. But they might include restrictions for too much time, or ones that force the party making the promise not to trade with anyone else with regard to too great a range of different products.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.5d contains a more complete discussion of output and requirements contracts.

5.4g Exculpatory Clauses Are Not Enforceable as to Intentional or Reckless Torts, but They May Be Enforceable as to Negligent Torts

Parties often place exculpatory clauses in their contracts. Exculpatory clauses are not enforceable as to intentional or reckless torts, but they may be enforceable as to negligent torts.

*** **DEFINITION:** An **exculpatory clause** is a clause that attempts to relieve a person of liability for future harm, generally for torts.

In some jurisdictions, exculpatory clauses are very common, especially in standard form agreements used by large businesses. However, that does not mean that courts always enforce them!

To understand these rules, it is necessary to know about a few basic aspects of torts. Torts are non-contractual civil wrongs. They were briefly explained in Sections 5.3a and 5.4b, above. Very basically, many jurisdictions say there are two main kinds of torts: intentional and unintentional.

Generally, an intentional tort occurs where a party intentionally commits an act that violates a non-contractual legal duty he owes to another person. An example might be where a party intentionally hits a pedestrian with his car.

An unintentional tort basically occurs where a party unintentionally violates a non-contractual legal duty he owes to another person. Some jurisdictions say that there are two types of unintentional torts: reckless and negligent.

Negligent torts occur where a person fails to meet a duty of care owed to others and by doing so causes harm. The person need not intend to commit the act that causes harm in order to commit a negligent tort. An example might occur where a party driving his car fails to drive carefully enough and unintentionally hits a pedestrian.

Reckless torts fall in between intentional and negligent torts. Such torts basically occur where parties do not intentionally cause harm, but perform acts in a way that shows genuine disregard for the danger their acts cause to the well-being of others. An example might be where a drunken person driving his car at night with no headlights unintentionally hits a pedestrian.

Suppose a health club has an exculpatory clause in the agreements it makes with members who exercise there. In such a clause, the club might try to deny responsibility for any injury to a member. The club probably could enforce the clause to avoid liability if a member tripped on a loose exercise mat and was injured, then claimed the club was negligent about keeping the area safe. But the club would not be able to enforce the clause to avoid liability

where a club employee punched a member intentionally and injured him--because that would be an intentional tort. The reason for these rules may be that courts do not wish to allow parties to negotiate rights to hurt others intentionally or recklessly, which may be more serious violations of public policy than negligence. Of course, negligence can also have very bad effects.

Even where exculpatory clauses only try to relieve parties from liability for negligence, many jurisdictions will not enforce them where even that enforcement would violate public policy. The situations where courts do this vary in different jurisdictions. In general, courts seem to feel that parties in some important positions in society should not even be able to negotiate the right to be negligent. We will briefly discuss two examples of such situations.

First, many jurisdictions will not enforce exculpatory clauses as to negligence if the party trying to enforce the clause is a provider of a public service trying to avoid liability for harm caused by its performance of that service, and the other party has no real ability to choose another provider of the service. An example might be a railroad trying to avoid liability for harm caused to passengers by its negligent maintenance of its trains.

Second, many jurisdictions will not enforce an exculpatory clause where the party trying to enforce it has much more bargaining power than the party against whom the clause is being enforced, and the weaker party has little real ability to bargain about the clause. An example might be where a large employer asks a new employee to sign a standard form contract relieving the employer from liability for all harm to the employee. This type of situation might occur where there is an unconscionable agreement. An unconscionable agreement basically occurs where the process of formation or actual terms of an agreement are so extremely unfair that it shocks the conscience of the court. Such agreements are especially likely where there are adhesion contracts. Those occur where a party with much greater bargaining power drafts and presents a contract to the other party in circumstances where that party has no real chance to negotiate about the terms. It is rare that courts refuse to enforce agreements because of unconscionability, but it is possible. These issues were briefly discussed in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4f, and they will be discussed in more detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.7.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.7 contains a more complete discussion of unconscionable agreements and adhesion contracts.

*** ***CASE STUDY 133***

FACTS Nikea is desperate to find a job. Camtex, a powerful textile company, hires Nikea for its new factory. Many other workers are unable to get jobs at the factory, and Nikea feels very lucky. On his first day of work, Camtex has Nikea sign a standard form employment agreement which

contains a clause saying Camtex will not be liable for any harm caused to Nikea (intentional or negligent).

One day during Nikea's third month on the job, his supervisor hits him for not working fast enough, injuring Nikea. As Nikea is walking across the factory floor to get health care, a different employee negligently drops a heavy machine on him, injuring him further. Nikea asks the court to order Camtex to pay him compensation for his injuries. Camtex says it is not liable for anything because of the exculpatory clause.

QUESTION OF LAW Can Camtex enforce the exculpatory clause?

DECISION Probably not. This exculpatory clause violates public policy as to intentional torts, and probably as to negligent torts also, in many jurisdictions.

Exculpatory clauses are not enforceable as to intentional or reckless torts. They are not enforceable as to negligent torts, in many jurisdictions, if the party trying to enforce the clause has much more bargaining power than the other party, and the other party has little ability to bargain about the clause.

In this case, Nikea signed an employment contract with an exculpatory clause that tried to relieve his employer Camtex of all liability for harm to Nikea. The Camtex supervisor's hitting of Nikea was an intentional tort, and no exculpatory clause can relieve Camtex of liability for that. The other employee's dropping of the machinery on Nikea was a negligent tort. Normally exculpatory clauses can relieve liability for negligent torts. But in this case, Camtex had much more bargaining power than Nikea, and Nikea had little real choice about the clause if he wanted the job. Many jurisdictions would not enforce this clause even as to negligent torts, because it would violate public policy to allow a party like Camtex to avoid liability in this situation.

The general effect of an unenforceable exculpatory clause is that the clause cannot be enforced, at least to the extent it tries to limit liability in violation of the above rules. However, as with clauses containing agreements not to compete, this will not cause the rest of the agreement to be unenforceable if the agreement can stand on its own without the clause. For example, an employment contract with an exculpatory clause would probably not become unenforceable simply because that one clause could not be enforced. This is called "severing" the illegal part of an agreement, and it will be discussed in Section 5.5b, below.

5.4h Agreements That Promote Immorality Generally Cannot Be Enforced

In many jurisdictions, an agreement that promotes immorality is illegal and unenforceable, even if the performance of the agreement itself

would normally be legal. "Immorality" is basically something contrary to the moral standards of a particular society.

For example, suppose it was normally legal to sell land mines, but in a particular case the seller knew the buyer was buying a mine in order to mine a busy road 15 minutes later. In that situation, a court might refuse to enforce the agreement, because it would be immoral.

Courts refuse to enforce agreements on this basis only in very limited circumstances. This is because what is "immoral" is very hard to define. It can change over time, and people often disagree about what it means. So courts refuse to enforce agreements on this basis only when they clearly promote immorality. Of course, people may also disagree about what is "clear."

In addition, different jurisdictions have different approaches to this area. Some may be more likely than others to refuse to enforce agreements on this basis. So it is very important to check the local law.

Usually courts require some clear expression of public policy, such as a statute, to show that an agreement is immoral. Without such an expression of public policy, it is rare that courts would refuse to enforce agreements because they are "immoral." For instance, in the example above, the mine seller may not be guilty of a crime if he sells the mine. But the criminal statutes defining murder and other wrongs that may result from mining might show that the mine sale was immoral.

Often, one party to this kind of agreement is much more involved in the immoral conduct than the other party--perhaps because that first party secretly plans to use the agreement to help him do something illegal! When this occurs, some jurisdictions say that the more "guilty" party cannot enforce the agreement. The more "innocent" party can enforce the agreement only if:

(1) he has substantially performed the agreement;

(2) he did not know about any misconduct of the more guilty party that involves grave social harm;

AND (3) he did not become actively involved in such misconduct.

*** ***CASE STUDY 134***

FACTS Thim sells chemicals. One day, Im tells Thim he will pay $1,000 for 20 barrels of a certain chemical, which it is legal to sell in Thim's nation and can be used to make a variety of lawful products. Thim loads the 20 barrels into Im's truck, and Im gives him the $1,000 and drives away.

About one week later, two police officers visit Thim. They tell him that Im used the chemicals to manufacture dangerous illegal drugs, and they say the money Im paid Thim was counterfeit money. They also mention that they

have not found any of the chemicals. Thim is very upset. He asks the court to enforce the agreement against Im so he can get a real $1,000 payment.

QUESTION OF LAW Can Thim enforce this agreement with Im?

DECISION Perhaps, in some jurisdictions. Although the agreement between Thim and Im may indirectly promote immorality, Thim was innocent of the immorality, so he may be able to enforce the agreement.

Courts will not generally enforce agreements that promote immorality. Where the performance of the agreement itself is legal, but one party plans to use the agreement to do something illegal, the more "guilty" party cannot enforce the agreement. However, some jurisdictions say that the more "innocent" party can enforce it if he has substantially performed, and he did not know about or become part of any grave social harm.

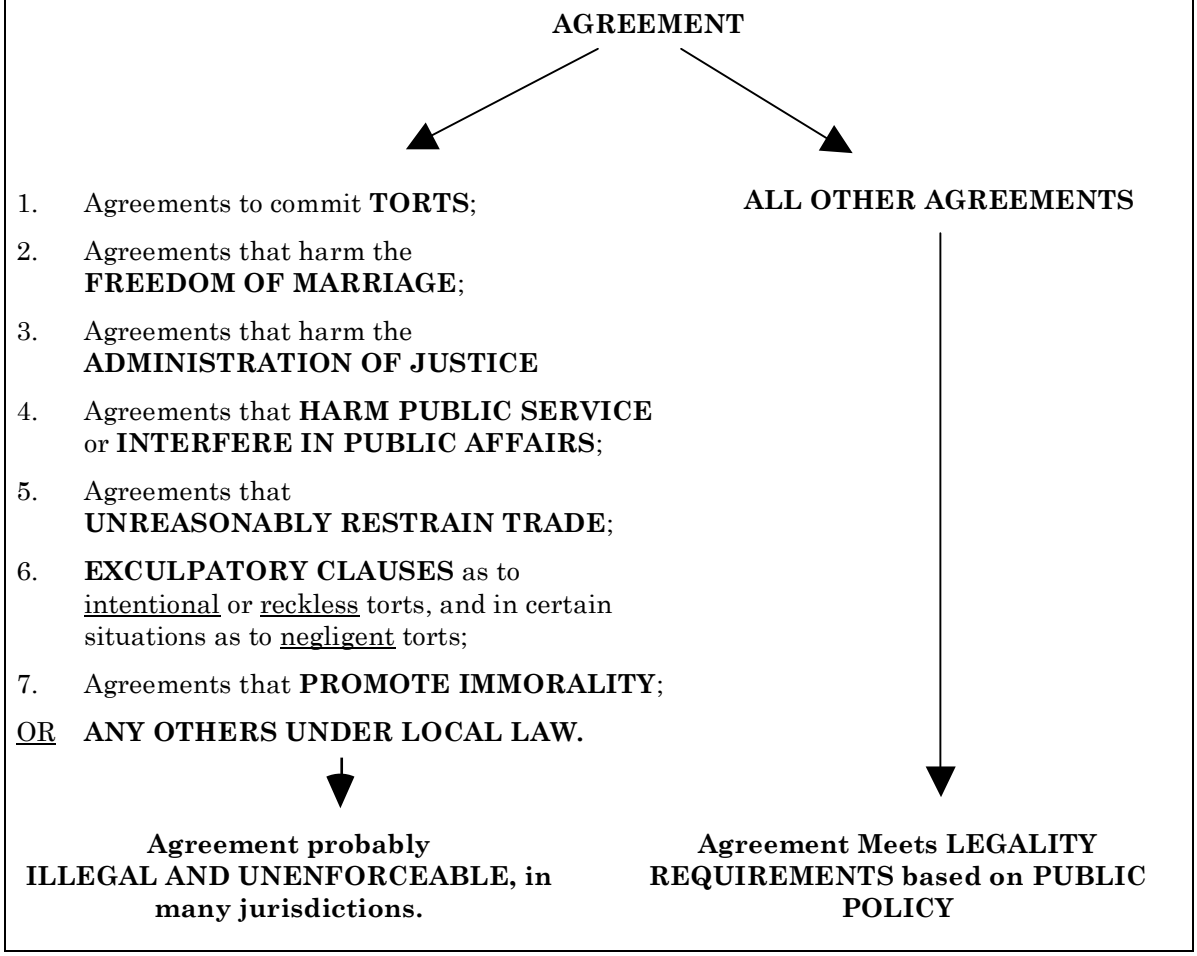
In this case, some jurisdictions would say that the agreement between Thim and Im for the sale of the chemicals promoted immorality, even though it was normally legal. This is because Im planned to (and did) use the chemicals to make dangerous illegal drugs. As the more guilty party, Im could not enforce the agreement. But Thim might be able to enforce it in some jurisdictions. This is because Thim substantially performed the agreement, and although Im's misconduct involved grave social harm, Thim did not know about or become actively involved in the misconduct.

5.4i Summary of Some Basic Rules about Agreements Prohibited by Public Policy

As discussed above in Sections 5.4a-h, certain types of agreements are prohibited by public policy, in many free market jurisdictions. The chart below summarizes some basic rules about such agreements.



Illustration: Some Basic Rules about Agreements Prohibited by Public Policy



5.5 The Effects of Illegality on Agreements

Although illegal agreements are generally unenforceable, there are limits on that rule. This Section will explain the general rule and some limits.

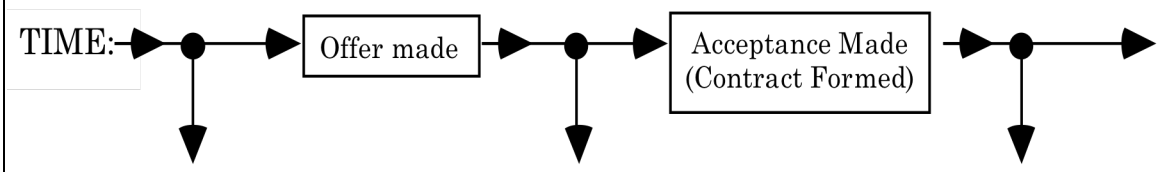
5.5a Illegal Agreements Are Generally Void, but in Certain Situations Parties May Be Able to Enforce Them or Get Restitution or Other Remedies

As noted above, illegal agreements are generally void. That means they generally cannot be enforced.

However, illegality has somewhat different effects on agreements depending on when the illegality occurs. If a proposed contract is illegal at the time an offer is made, no valid contract can result, as discussed in this Chapter. If an offer becomes illegal after it is made but before acceptance, it appears that many jurisdictions say the offer terminates, as explained in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e.

No valid contract can result. Finally, if a contract becomes illegal after it is formed, the duties under the contract will probably be discharged under the doctrines of impossibility or impracticability, as discussed in Chapter 9 ("Performance and Discharge of Duties"), Section 9.8a. Of course, in all of these situations, the contract or proposed contract cannot be enforced once it becomes illegal. The chart below illustrates these possibilities.

Illustration: General Effects of Time on Illegal Agreements



Agreement illegal at time offer made-- NO valid contract possible. See this Chapter.

Offer becomes illegal after offer made but before acceptance-- Offer TERMINATES Automatically; NO valid contract possible. See Chapter 2, Section 2.6e, and this Chapter.

Contract becomes illegal after valid contract formed-- Contract NO LONGER enforceable; duties may be DISCHARGED because agreement now impossible to perform. See Chapter 9, Section 9.8a.

Although illegal agreements cannot generally be enforced, and nothing transferred under them can generally be recovered, there are several limits on that general rule in some jurisdictions. These limits are discussed in the following Sections.

(1) One Party May Be Able to Enforce an Illegal Agreement in Certain Situations

In a few limited situations, one party to an illegal agreement may actually be able to enforce it. We will discuss two of these special situations.

First, some jurisdictions say that a person not aware of the illegality may be able to enforce the agreement under certain limited circumstances. In particular, the unaware party may be able to enforce the agreement where there is a contract that would normally be legal, but one of the parties secretly intends to use it for some illegal purpose. This was already discussed in Section 5.4h, which explained about agreements that violate public policy because they promote immorality.

For example, in Case Study 134, the chemical seller Thim might be able to enforce the agreement he made with Im. That is because the sale itself would normally be a lawful agreement, and Thim did not know that Im planned to use the chemicals to manufacture illegal drugs. However, it seems unlikely that a court would enforce such an agreement if it would assist

the guilty party in furthering the illegality. For example, in Case Study 134, it seems unlikely that a court would ever order Thim to actually give Im the chemicals if it knew of the illegal plan--even if it was Thim who asked the court to enforce the agreement.

Second, sometimes one party is in a special class protected by statute or public policy. In that situation, an agreement that violates the statute or policy may not prevent a party in that special class from enforcing the illegal agreement.

For example, in many jurisdictions, minimum wage statutes require that all full time workers (with a few exceptions) be paid no less than a certain amount of money per hour. If an employment agreement violates these laws, the employer cannot enforce the agreement. But the employee can enforce the agreement--and at the legal minimum wage, not the lower wage the employer agreed to pay!

(2) Restitution or Other Remedies May Be Available in Certain Situations

There are also a few situations where parties to an illegal agreement may be able to get restitution or other remedies. In particular, parties may in certain cases be able to get restitution even though the illegal agreement is not enforceable. And it seems possible that a party to an illegal agreement might in very limited situations be able to get a remedy based on promissory estoppel, if he justifiably relied on a promise and harm would result if the promise was not enforced to some extent. These possibilities are briefly discussed below.

Restitution may be possible in certain situations involving illegal agreements, under the doctrine of quasi-contract. Two of these situations might be called the "withdrawal" situation, and the "less guilty" situation.

First, restitution may be available where a party withdraws from an illegal agreement. In particular, some jurisdictions allow restitution where:

(1) a party withdraws from the agreement before its improper goal has been reached; AND

(2) the withdrawing party has done nothing seriously wrong.

To get restitution in this situation, a party must refuse any further participation in the illegal agreement.

******* ***CASE STUDY 135***

FACTS Bora and Chheng agree that they will find harmful information about Bora's uncle Sim, then blackmail him. Blackmail is a crime. Bora and Chheng agree that Chheng will give Bora $1,000 so he can get the information

they need, which will require time, travel and many bribes. Chheng gives Bora the money.

However, a few hours later, Chheng decides that she no longer wishes to blackmail Sim. She tells Bora that she is withdrawing from the agreement, and asks him to give her $1,000 back. But Bora says no. Chheng asks the court for help.

QUESTION OF LAW Can Chheng get her $1,000 back from Bora?

DECISION Perhaps. Although this illegal blackmail agreement is not enforceable, Chheng might be able get restitution of her $1,000, because she withdrew from the agreement before the improper goal was reached and before she did anything seriously wrong.

In some jurisdictions, parties can get restitution of what they have given under an illegal agreement if they withdraw from it before the illegal goal has been reached, and they have done nothing seriously wrong. In this case, the blackmail agreement between Chheng and Bora was illegal and could not be enforced. However, Chheng withdrew from the agreement before its goal was reached, and without doing anything seriously wrong. So she might be able to get restitution of the $1,000 she gave Bora.

Of course, some courts might say that she did do something seriously wrong--and so there is no "unjust enrichment"--because she agreed to commit blackmail, a serious crime. What do you think?

Another special situation where some jurisdictions may allow a party restitution is where that party is significantly "less guilty" than the other party. In particular, some jurisdictions allow restitution where:

(1) one party is significantly less "guilty" than the other party; and

(2) that less guilty party has done nothing seriously wrong.

Obviously, if this exception was used too much, courts might end up enforcing many illegal agreements--since there may be many situations where one party is somewhat more "guilty" than the other. So courts are very careful to allow recovery here only in very limited circumstances. One possible example is where a minor purchases prohibited articles, as discussed in Section 5.3a.

*** ***CASE STUDY 136***

FACTS Diva is a nurse whose nation has been torn apart by a bloody civil war fought mostly between two ethnic groups. The ethnic group to which Diva belongs is about to lose the war. Persons in her ethnic group are trying desperately to escape the country before their territory is finally captured, because they know that if they do not escape, they will probably be killed by the other ethnic group. However, it is very difficult to escape.

Diva tries many ways to get a visa to settle in a foreign nation, but she has no success. Finally, she agrees to give all her gold and jewels to a government official named Siphann if he will agree to (illegally) get her a visa to Redland. From Redland, Diva hopes to reach Blueland, a safe nation which some of her family has managed to reach. However, after taking the gold and jewels, Siphann disappears.

Diva is very tough, and she escapes anyway. Two years later, after Diva has found her family and is living with them in the capital city of Blueland, she happens to see Siphann on the street. She grabs him and drags him to court, where she asks the judge for help in recovering her gold and jewelry.

QUESTION OF LAW Can Diva get restitution of her gold and jewelry?

DECISION Yes, in some jurisdictions. Although the agreement to get the Redland visa was illegal, Diva is far less guilty of wrongdoing than Siphann, and she has done nothing seriously wrong in attempting to save her own life.

Some jurisdictions allow a party to an illegal agreement to get restitution if that party is significantly less guilty than the other party, and she has done nothing seriously wrong. In this case, the agreement between Diva and Siphann to get the Redland visa was illegal and unenforceable.

However, some jurisdictions might allow restitution for Diva. This is because Diva appears to be significantly less guilty than Siphann. And she did nothing seriously wrong in attempting to escape her war torn nation and save her own life. Siphann appears to be more "guilty" because--although both parties made the illegal agreement together--Siphann made the agreement in order to make a large profit (rather than to save a life). In addition, Siphann left Diva in an even weaker position than she had been in before--by taking her gold and jewelry but doing nothing in return! So courts in some jurisdictions might order Siphann to return her jewelry and gold, or its reasonable value.

Finally, it seems possible that a party might make a promise as part of an illegal agreement that would meet the requirements of promissory estoppel, even though that agreement could not be enforced under the usual contract law rules. As noted previously, promissory estoppel is a doctrine some common law jurisdictions apply where one party justifiably relies on a promise by another party, and injustice will result if the promise is not enforced, at least to some extent. Of course, it would seem rare that it would be "justifiable" to rely on a promise given as part of an illegal agreement.

However, one situation where it seems possible would be where two parties agree to marry, one party spends money on wedding preparations, the other party refuses to marry, and the law will not enforce the agreement because that would violate public policy. This potential problem was noted in Section 5.4c above. In this situation, restitution would not help the party

who spent money, unless that money had gone to the other party. However, reliance damages--which seek to put a party in the position he occupied before the agreement was made--would compensate the party who spent money. The injured party might argue that he justifiably relied on the other party's promise to marry, and injustice would result if the other party did not compensate him for the money he spent, or at least share the expense.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains further discussion of quasi-contract; Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e discusses promissory estoppel; Chapter 7 ("Other Contract Formation Problems"), Section 7.8 contains more detailed discussion of promissory estoppel; and Chapter 10 ("Remedies"), Section 10.4 contains further discussion of restitution.

5.5b Sometimes Courts "Sever" the Illegal Part of an Agreement and Enforce the Rest

Illegal agreements are unenforceable only to the extent that the illegality violates a statute or public policy. So if the illegality in an agreement does not extend to the whole contract, many courts will enforce the rest of the agreement if it can stand on its own without the illegal part. This practice of removing the illegal part of an agreement and enforcing the rest is called "severance."

*** **DEFINITION: Severance** is a court's removal of unenforceable parts of an agreement, leaving behind an agreement the court will enforce.

Illegal parts of an agreement can be severed only if the severing does not destroy the whole meaning and purpose of the contract. In other words, an illegal part of an agreement can be severed where it leaves the remaining part of the contract capable of standing alone. For example, agreements to commit murder or bribe public officials cannot be partly enforced, because the illegality is the main part of the agreement. But illegal exculpatory clauses or "non-competition" clauses in employment agreements might be severable, since the rest of such agreements might be capable of standing alone, without the illegal clauses. Likewise, agreements for the sale of different kinds of goods (some legal and some illegal) might be severable, because a court might be able to sever the illegal parts and enforce the rest.

In general, courts do not wish to rewrite agreements for the parties. That might produce something entirely different from what the parties intended. Courts wish to respect the principle of freedom of contract as much as possible--even as to persons who make illegal agreements. So if a court cannot sever and leave a contract that can be enforced basically as the parties intended, the agreement will not be enforced.

Specifically, many jurisdictions require three elements for severance of illegal parts of agreements:

(1) the court must be able to divide the remaining agreement into corresponding performances between the parties;

(2) the illegality must not affect the whole agreement;

AND (3) there must have been no serious wrongdoing by the party trying to enforce the agreement.

Consider the following Case Study.

*** ***CASE STUDY 137***

FACTS Vorn, a self-employed lorry driver, made an agreement to haul three loads of hardwood and three loads of rattan wood from a logging company site to the nearest sea port for export. Vorn's fee was 100,000 riels per load.

Unfortunately, because of overlogging, it was illegal to haul or export hardwood when the agreement was made. When Vorn learned this, he told the logging company that he would haul the rattan wood, but not the hardwood. The company said he had to haul all of the wood or none.

QUESTION OF LAW Can Vorn enforce this agreement as to the rattan wood only?

DECISION Possibly. The part of the agreement to haul hardwood was void because it was illegal, but if that part could be severed, the agreement to haul the rattan might be enforceable, in some jurisdictions.

In some jurisdictions, where part of an agreement is unenforceable because it is illegal, a court may still enforce the rest of the agreement if the illegal part can be severed without destroying the main part of the agreement. In this case, Vorn agreed to haul six loads of wood: three loads were illegal (the hardwood), but three loads were not illegal (the rattan wood). Vorn's fee was 100,000 riels per load. In this situation, it seems fairly easy to sever the hardwood hauls and simply enforce the rest of the agreement: three rattan wood loads at 100,000 riels per load. So in this case, a court might sever the illegal part of Vorn's agreement and enforce the legal part.

Where a part of an agreement is normally allowed within certain limits, but the agreement goes too far, the court may simply enforce the agreement within the limits. For example, some courts might enforce a usurious loan agreement, but only at the legal rate. Similarly, unreasonable promises not to compete in employment agreements might be enforceable, but only within legal limits.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.7c discusses severance of unconscionable parts of agreements; and Chapter 10 ("Remedies"), Section 10.7c discusses severance of parts of contracts in general.

5.6 Illegality in the Cambodian Legal Tradition and the Civil Law Tradition

*** ***CAMBODIAN LAW PERSPECTIVE:*** Many Cambodian laws address the legality of contracts, and the approach they show seems generally compatible with the approach discussed in this Chapter. These laws include the Constitution (1993), the Contract Law (Decree #38D (1988)), the Marriage and the Family Law (1989), the Land Law (Decree #100D (1992)), the Labor Law (1997), and the Zoning Law (1994).

I Basic Rules

Article 3 of Decree #38D, the current Contract Law of Cambodia, states that every contract is valid provided that, among other things, it "has a subject matter that is lawful." Article 5 of the Decree provides that agreements are void if they are, among other things, "illegal," "not consistent with public order or good custom," or "not consistent with social interests or principles of social ethics." These latter phrases may describe agreements that are not enforceable because they violate Cambodian public policy. No definition of these standards appears in the Contract Law. So it would seem that, as with public policy in many other jurisdictions, the courts must determine what it is.

In general, these provisions seem consistent with the approach discussed in this Chapter with respect to legality. One possible difference is that the phrases "social interests" and "social ethics" may suggest that courts may refuse to enforce agreements in a broader range of situations than courts in some other free market jurisdictions.

II Specific Kinds of Illegal Agreements

Crimes and Torts

Cambodia has a number of criminal laws, including the Law on Criminal Procedure (1993) and the UNTAC Penal Code (1992). In addition, the Constitution (1993) and the Drug Law (1996) regulate acts related to certain prohibited articles, such as illegal drugs and unsafe consumer goods. It seems likely that no court would enforce an agreement that violated one of these laws.

In addition, Articles 121-135bis of Decree #38D discuss "Other Liabilities," and provide that anyone damaged by the fault of others may get compensation for that damage. These provisions appear to describe

non-contractual civil wrongs (torts). Agreements violating the above articles would almost certainly be unenforceable.

Gambling

The Law on the Suppression of Gambling (1996) regulates gambling in Cambodia. Presumably agreements that violate this law would be unenforceable.

Usury

Article 59 of Decree #38D says that the maximum legal interest rate on a loan is 5% per year, except where the law sets a different rate. Article 60 provides that any usurious interest already paid by a borrower shall be deducted from the loan principal and considered part of the repayment of that principal, or returned to the borrower (with interest for the borrower) if the borrower has paid more than the total amount allowed by the law. This is similar to severance, which was explained in this Chapter. Article 60 also says that the lender will be subject to criminal law.

Licensing

Cambodian law has some licensing requirements. One example is the Bar Statute (1995), which provides that only licensed Cambodian lawyers may practice law in Cambodia.

Another example appears in Article 15 of the Zoning Law (1994), under which only certified Khmer architects, or anyone recognized by the competent authorities, may prepare certain parts of a request for permission to build "large construction." It is not clear if agreements made by those who violate these licensing requirements are enforceable.

Restraint of Trade

The current Cambodian Labor Law (1997) deals with restraint of trade in Article 70. Article 70 provides that all contract provisions that "prohibit the worker from engaging in any activity after the expiration of the contract" are void. This appears to invalidate all non-competition clauses in labor contracts. It appears to differ from the approach discussed in this Chapter, which allows such restrictions in labor contracts if they are reasonable as to time and place.

Marriage

Article 45 of the Constitution provides that "marriage shall be conducted according to conditions determined by law based on the principle of mutual consent between one husband and his wife." This would appear to mean that marriage without the consent of one of the parties would be illegal and unenforceable. It is not clear if other agreements related to marriage (such as agreements to marry or not marry) are enforceable.

The Law on Marriage and the Family (1989) also deals with marriage and its legality. Articles 6 to 8 of the Marriage Law prohibit certain marriages, including marriages to those who are already married.

Public Affairs

Article 55 of the Constitution provides that "any treaty and agreement incompatible with the independence, sovereignty, territorial integrity, neutrality and national unity of the Kingdom of Cambodia shall be annulled." This may prohibit agreements that interfere in public affairs and harm the national interest, as discussed in this Chapter. Such agreements would appear to be void.

Sale of Land and Other Property

Article 44 of the Constitution declares that only "Khmer" legal entities and "Khmer" citizens may own land, and there are similar provisions in the Land Law (1992) and the Investment Law (1994). This was explained in the Cambodian Law Perspective in Chapter 4 ("Capacity"). Agreements violating these provisions would be illegal. Article 48 of Decree #38 also provides that if a vendor obtained property by way of a felony or misdemeanor, the purchaser could ask to rescind the contract, even if there was no threat from a third party to deprive the purchaser of the property. Article 48 says that agreements contrary to it are void.

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to legality appears to be generally compatible with the approach discussed in this Chapter. Of course, there are some differences, and the law varies to some extent in different jurisdictions.

In France, the general policy of freedom of contract is limited by the requirement of legality. This requirement is specified in statutes--including at least one about public policy. The *Code Civil* states that, for an agreement to meet the requirement of legality, it must have a licit *cause*. *Cause* is basically the reason or purpose a party made the agreement. The *Code* provides that a *cause* is illicit when it is prohibited by statute, or when it is contrary to morality or to public order (*ordre public*). *Ordre public* appears to be very roughly comparable to the idea of "public policy" discussed in this Chapter. It is formulated by the courts and changes with new social conditions.

The French *Code Civil* also states that if a *cause* is illicit then "the obligation can have no effect." This means that an illegal agreement is void, and courts will not enforce it. It appears that an illegal agreement is not void if one party does not know of the illegal intention of the other party. If that occurs, it appears that the innocent party may enforce the contract.

5.7 Questions for Review

CHAPTER 5 -- QUESTIONS FOR REVIEW

1. What is the general effect of an illegal agreement?
2. Will courts enforce agreements to violate criminal or tort statutes?
3. In general, will courts enforce gambling agreements? Why?
4. What are the effects of usurious loan agreements?
5. Will courts enforce agreements made by persons who have violated regulatory licensing statutes?
6. Will courts enforce agreements that unreasonably restrain trade? Why?
7. Give examples of unreasonable trade restraints.
8. What is public policy?
9. Will courts enforce agreements to commit torts, even where no statute specifically defines such torts?
10. Will courts enforce agreements that harm the freedom of marriage?
11. Will courts enforce agreements that harm the administration of justice?
12. Will courts enforce agreements that harm public service? Why?
13. Give examples of agreements that harm public service.
14. Will courts enforce agreements that unreasonably restrain trade, even if no specific statute prohibits the restraint? Give examples.
15. Will courts enforce exculpatory clauses?
16. Will courts enforce agreements that promote immorality?
17. Will courts enforce illegal agreements? Will they give any remedies?
18. What does severance mean? When will some courts do that?
19. Is the approach to legality discussed in this Chapter generally compatible with the current Cambodian law approach?
20. Is the approach to legality discussed in this Chapter generally compatible with the civil law approach?

CHAPTER SIX

FORMALITY

6.1 Introduction

Free market jurisdictions have certain formality requirements about contracts, as explained briefly in Chapter 1 ("Basic Aspects of Contract Law"). Legal rules about formality requirements vary in different jurisdictions. But many jurisdictions share certain basic principles. This Chapter will discuss some of these principles.

Probably the most important type of formality requirement is a writing requirement. Contracts can generally be enforced even if they are not written. However, all important contracts should be written in a proper form. This is discussed in Section 6.2 below.

Statutes in many free market jurisdictions say that certain important types of contracts must be in a particular written form in order to be enforceable. Specifically, many jurisdictions say that writings are generally required for: agreements to transfer a substantial interest in land; agreements that cannot be performed within one year; suretyship agreements; certain agreements relating to marriage; and agreements for the sale of goods over a certain monetary amount. And there are other types of contracts which many jurisdictions require to be written. However, there are a number of situations where many jurisdictions say such agreements can be enforced even though the writing requirement is not met. Three of these exceptions are where the contract is fully performed, where it is admitted in court, and where promissory estoppel applies. Other exceptions apply to specific writing requirements. These requirements and exceptions are explained in Sections 6.3-6.4.

Modifications of contracts are subject to the same writing requirements as the original contracts were. This is discussed in Section 6.5.

When the law requires a writing for a contract to be enforceable, the law is generally flexible about the physical form of the writing, and the circumstances under which the writing is created. However, many jurisdictions say the writing must contain the essential terms of the contract, and the identity and signature of the party against whom the contract is being enforced. This is explained in Section 6.6.

Agreements that fail to meet writing requirements are generally unenforceable. Statutes in some jurisdictions say agreements that fail to meet the requirements are void. However, many jurisdictions say that such agreements can be enforced in certain situations. In fact, in some situations, the agreements may be valid, because of the exceptions noted above. In other cases, one party may be able to enforce such agreements. In addition, even where an agreement cannot be enforced because a writing requirement is not met, restitution is generally available. This is discussed in Section 6.7.

Most jurisdictions also have formality requirements other than writing requirements. These are discussed briefly in Section 6.8, below.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4e contains a more concise discussion of formality requirements.

6.2 Contracts Can Generally Be Enforced Even If They Are Not Written, but All Important Contracts Should Be Written in a Proper Form

Unwritten contracts--oral or implied--can generally be enforced. The law recognizes that it is not practical for parties to put all contracts in writing. This is especially true about everyday contracts, such as for the sale of a cup of tea, or a kilo of onions. And in the case of implied contracts, the law recognizes that sometimes it is not practical or necessary for parties even to use words to make their contracts! This was discussed in some detail in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3d.

However, the law wants to encourage people making important contracts to use words, and to put those contracts in a proper written form. To achieve this goal, the law generally requires certain types of contracts to be in such a form in order to be enforceable. One example is contracts for the sale of land. In addition, it is wise to put all important contracts in writing--even if the law does not require it.

*** ***WHY IS THIS IMPORTANT?*** Why does the law require certain types of contracts to be written, and why is it a good idea to put any important contract in writing?

A written contract that accurately records the agreement of the parties has several advantages over oral and implied contracts. These advantages benefit both the parties to the contract and a court asked to enforce the contract. Some of these advantages are discussed below.

First, if the contract is in writing, its existence cannot easily be denied by a party who may be seeking to escape her obligations. This is because the writing serves as strong proof that a contract was made. For example, if the parties made an oral agreement without any other witnesses, one party

might deny that any contract was formed. And there may be a higher risk of this where the parties do not know each other well. The law wishes to avoid this situation. In fact, a famous English statute which was adopted in 1677 and became the basis of most common law writing requirements is known as the "Statute of Frauds." Statutes like this are designed to prevent frauds and perjury (lying under oath).

Second, if the contract is in writing, the parties' obligations are more clearly defined, and kept in a durable form. Clear written evidence is better than oral evidence. Courts may sometimes have trouble enforcing oral or implied contracts, because the testimony given by some witnesses may conflict with that of other witnesses. In fact, as noted above, it is unfortunately true that some parties may lie to the court about the terms of such contracts. Writing requirements like the Statute of Frauds protect parties from that possibility by providing strong proof of the contract terms. Moreover, written contracts are often more durable than human memory. One of the parties may die, or become ill or unavailable for some reason. If a party dies, the executor or administrator of her estate may be unable to enforce an oral agreement previously made by the deceased person. And even if no one becomes unavailable, parties may simply forget the exact nature of some terms of an unwritten contract as time passes.

Third, writing requirements should make parties think more carefully about whether they should make the contract or not. Often, people pay more attention to the terms of a contract if they must put it in writing. People may also be forced to consider the future consequences of making the contract. The law wants to encourage this kind of careful consideration about important contracts. This should help to avoid disputes, or at least simplify them. It may also protect parties from making mistakes because of momentary impulses.

So most parties (especially governments and business people) prefer to have contracts regarding important matters put in writing--even when the law does not require it! Written contracts protect the interests of the parties. In addition, as noted above, legislatures and courts also prefer written contracts. This is because written contracts can help avoid disputes; guide the resolution of any disputes that do arise, by showing more clearly what the parties agreed; and thus promote social harmony and efficiency in the economy.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3d discusses the various forms contracts may take.

6.3 Certain Important Contracts Must Generally Be Written to Be Enforceable

As noted above, many jurisdictions say that certain types of contracts generally must be written in a proper form in order to be enforceable.

This rule generally means that parties must meet the writing requirement if they wish to enforce such contracts. However, there are some important limits on that general rule, which are discussed below.

Writing requirements are usually contained in statutes. This is true even in common law jurisdictions, where some other legal rules are developed in court decisions. The statutes of different jurisdictions contain many different writing requirements.

Section 6.3 provides a basic overview of some important types of agreements that many jurisdictions generally require to be written. But first, Section 6.3a discusses three general exceptions to the rule that these types of agreements or promises must be written to be enforceable. These situations are where an agreement is fully executed; where an agreement is admitted in court by the party against whom enforcement is sought; and where promissory estoppel applies. In these situations, many jurisdictions say the agreement or promise may be enforceable despite the failure to meet a writing requirement. These general exceptions are explained first so that they need not be explained repeatedly in the discussions of specific writing requirements which follow in the rest of Section 6.3.

Then, Sections 6.3b-6.3f discuss five important types of agreements which the laws of many jurisdictions generally require to be written in order to be enforceable:

(1) an agreement to transfer a substantial interest in land (Section 6.3b);

(2) an agreement which cannot possibly be performed within one year from the time the contract is made (Section 6.3c);

(3) a suretyship agreement, which is one to be responsible for the contract performance of another person (Section 6.3d);

(4) an agreement in which the promise of one person is made in exchange for marriage or the promise of marriage (Section 6.3e);

AND (5) an agreement for the sale of goods over a certain monetary amount (Section 6.3f).

In general, in many jurisdictions, a contract must be written if it falls into any one of these categories. For example, a contract for the sale of goods below the statutory level would still be required to be written if the contract could not be performed within one year.

There are many other types of agreements that jurisdictions may require to be written to be enforceable, such as agreements for the sale of securities. Section 6.3g discusses some of these other requirements.

6.3a Situations Where Agreements or Promises Might Be Enforced Despite a Failure to Meet Writing Requirements: Executed Contracts, Admission in Court, and Promissory Estoppel

Before discussing some of the specific types of agreements some jurisdictions require to be written, the text will explain three important general exceptions to these requirements. "General exceptions" means exceptions that apply to all types of contracts or promises. There are also special exceptions that apply only to particular writing requirements. Those special exceptions are discussed in the Sections below that explain the particular requirement to which the exceptions apply.

The first general exception is that, in many jurisdictions, writing requirements apply only to executory contracts. That is, the writing requirements apply only to contracts which have not yet been fully performed.

For example, two parties may make an oral contract for the sale of very expensive goods, which the law normally requires to be written to be enforceable. But if both parties fully perform the oral agreement, the writing requirement no longer applies. So neither party can use the lack of a writing as a basis to demand a remedy, such as restitution.

Second, in many jurisdictions, if a party admits in court that there was a contract, or fails to claim correctly in court that the writing requirement was not met, then the contract is enforceable against that party. So the other party can enforce an agreement that fails to meet a writing requirement in that situation, at least to the extent the first party admits the terms of the contract.

For example, a party may admit that she made an oral contract for the sale of goods that would normally require a writing. But she may say it was for only half as many goods as the other party claims. In that situation, a court will enforce the contract to the extent of half the goods--even if there is no writing.

The effect of this second exception is that contracts in this situation appear to be basically voidable by any party who has not signed a sufficient writing. This may be both parties to the contract, or only one party, because sometimes one party signs a sufficient writing but the other party does not. Parties who have not signed a sufficient writing can actually choose whether to avoid the contract--by using the lack of a sufficient writing as a legal defense--or not to avoid the contract. This situation is somewhat like contracts made by persons with only partial capacity, such as minors. Of course, if there is no writing at all, then the situation is more like a contract made by two minors--either party can generally avoid it. What the law requires for a sufficient writing will be discussed in detail in Section 6.6, below.

Third, in common law jurisdictions, promises may be enforceable, even where there is a failure to meet a writing requirement, if the elements

of promissory estoppel are met. As explained earlier, promissory estoppel basically says that a promise may be enforceable where a party justifiably relies on it and injustice might result if it is not enforced--even where the promise fails to meet the usual requirements for an enforceable contract, such as writing requirements. Promissory estoppel was explained to some extent in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, and it is explained in more detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

For example, Case Study 175 in Chapter 7 shows how a court might enforce a promise based on promissory estoppel even though there is a failure to meet a writing requirement. In that case, the court uses promissory estoppel to enforce a promise of two parents to transfer their farm to their son--even though they had failed to meet a writing requirement--because the son had justifiably relied on the promise by leaving university and returning home to work on the farm for some years.

In situations where these general exceptions apply--or where some other special exceptions that will be discussed below apply--agreements that fail to meet writing requirements may actually be enforceable. In those situations, the agreements may be similar to voidable, or even valid.

******* ***WHY IS THIS IMPORTANT?*** Why does the law allow parties to enforce agreements that fail to meet writing requirements in certain situations?

It appears that the law allows parties to enforce such contracts in certain situations, such as when a party admits in court that the contract exists, because these writing requirements are in fact formal requirements. That means they are really more about the form--and not the substance--of agreements parties make. And although there are good reasons for the law to require some contracts to be written in a certain form, the law also believes that substance is often more important than form.

As discussed above, the law wishes to encourage parties to put important agreements in writing. This protects parties from inaccurate testimony about the existence and terms of important contracts. But many legislatures and courts do not wish to say that agreements that fail to meet the writing requirements are always void. The reason is that--unlike some of the void agreements discussed in other Chapters of this text--these agreements may be real agreements, made by competent adults, with legitimate purposes and no other formation problems. It appears that courts will enforce these agreements in some specific situations because they believe that it would be unproductive, and perhaps unfair to one or both parties, not to do so. For example, it is hard to see why a court should not enforce a legitimate agreement that has been completely performed, or admitted in court, simply because the agreement is not written in a certain form. In these situations--where the parties have basically confirmed that there was a contract, either by

performance or court admission--it seems less likely that there would be a good faith dispute about the existence or terms of the agreement. Promissory estoppel protects parties who justifiably rely on promises in a variety of situations. And in some of the special exceptions discussed in the Sections below, there may be other policy reasons not to require a writing.

Of course, if there are too many situations where courts will enforce agreements that fail to meet writing requirements, parties may have less motivation to put such agreements in writing! So it may be difficult to say when such agreements should be enforced, and when they should not. In making rules in this area, the law tries to balance its desire to encourage parties to put important agreements in writing with its desire to enforce real, legitimate agreements.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3c contains a more complete discussion of executory and executed contracts; and Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, and Chapter 7 ("Other Contract Formation Problems"), Section 7.8 contain further discussion of promissory estoppel.

6.3b Agreements to Transfer Substantial Interests in Land Must Generally Be Written

In most jurisdictions, agreements to transfer a substantial interest in land must generally be written in order to be enforceable. Sometimes it is not easy to know whether something really is a "substantial interest in land" and therefore subject to the writing requirement. In this situation, "land" basically means the ground and anything strongly attached to it, like a building or a tree. An "interest" in land basically means a right a person has in the land. So an interest in land under this writing requirement does not mean only the ownership of real property, but also includes other substantial interests in such property.

What is considered a "substantial interest" in land depends on the jurisdiction. In many jurisdictions, this requirement generally applies to:

(1) agreements for the sale of land;

(2) leases for more than one year;

(3) agreements for easements for more than one year;

(4) mortgage agreements;

AND (5) agreements for the sale of rights to timber, minerals, structures, or similar materials to be removed from the land by the buyer.

Following are brief definitions of some of these property terms.

*** **DEFINITION:** A **lease** is an agreement to rent property; that is, an agreement in which one party promises to allow another party to possess (but not own) real or personal property for a certain amount of time.

*** **DEFINITION:** An **easement** is basically a right to use (but not possess) the real property of another person in a specified way, such as a right to cross the property to reach a road.

*** **DEFINITION:** A **mortgage** is an interest in land which secures (or guarantees) the performance of some obligation, usually the repayment of a debt.

*** ***CASE STUDY 139***

FACTS Chamroeun orally agreed to sell his house and land to Sitha for $100,000. But soon after that, Sitha saw how badly the property and road nearby became flooded during the rainy season. In fact, it was a mess! Sitha decided he did not want to buy the property after all. So he refused to go through with the agreement with Chamroeun. Chamroeun asks the court to enforce the agreement.

QUESTION OF LAW Can Chamroeun enforce this agreement against Sitha?

DECISION No. Chamroeun cannot enforce this agreement because it was an oral agreement for the sale of land.

Contracts involving the sale of a substantial interest in land, such as its sale, must be in writing in order to be enforceable. In this case, Chamroeun failed to make a written contract with Sitha about Sitha's purchase of his land. Instead, their agreement was oral. So Chamroeun cannot enforce the agreement.

On the other hand, some agreements that relate to interests in land are not generally subject to this writing requirement. These agreements include:

(1) an agreement to buy crops, which are generally considered to be goods;

(2) an agreement to build a building on land;

AND (3) a partnership or joint venture agreement in which the parties agree they will later buy and sell land (as long as the agreement contains no specific transfer of land interests).

In addition, in many jurisdictions, there are four exceptions to the general rule that agreements for the transfer of a substantial interest in land must be written to be enforceable. In these special situations, courts will enforce such agreements even though they do not meet the writing requirement! These exceptions occur where:

(1) contracts are executed;

(2) contracts are admitted in court;

(3) promissory estoppel applies;

OR (4) contracts are partly performed, under certain circumstances (in some jurisdictions).

The first three exceptions have already been explained in Section 6.3a, above.

The fourth exception is that some jurisdictions will allow buyers of interests in land to enforce agreements that do not meet the writing requirement if the buyer has already: (1) performed part of the contract, and (2) changed her position substantially in reliance on the agreement. How much performance and reliance is required to make such agreements enforceable varies in different jurisdictions. A jurisdiction may require that the person have taken possession of the property, or paid part of the purchase price, or made some improvement to the property, or some combination of the above possibilities.

******* ***CASE STUDY 140***

FACTS Sambo is tired of living in the big city. So she orally agrees to buy a piece of land in Ratanakiri from Chuon for $2,000. The terms are that Sambo will make a down payment of $300, and pay $200 each month after that until the total amount is paid. The agreement gives Sambo the right to possess the land immediately.

Sambo pays Chuon the $300 down payment, moves onto the land with her whole family, and builds a new house on the land. She makes several monthly payments on time, and she and her family are enjoying the land very much.

But one day, Chuon comes to see Sambo, returns the money Sambo has already paid, and tells her he has changed his mind about selling her the land. Chuon says he wants Sambo to leave the property, and that she must do so because the agreement was oral.

QUESTION OF LAW Can Sambo enforce this contract?

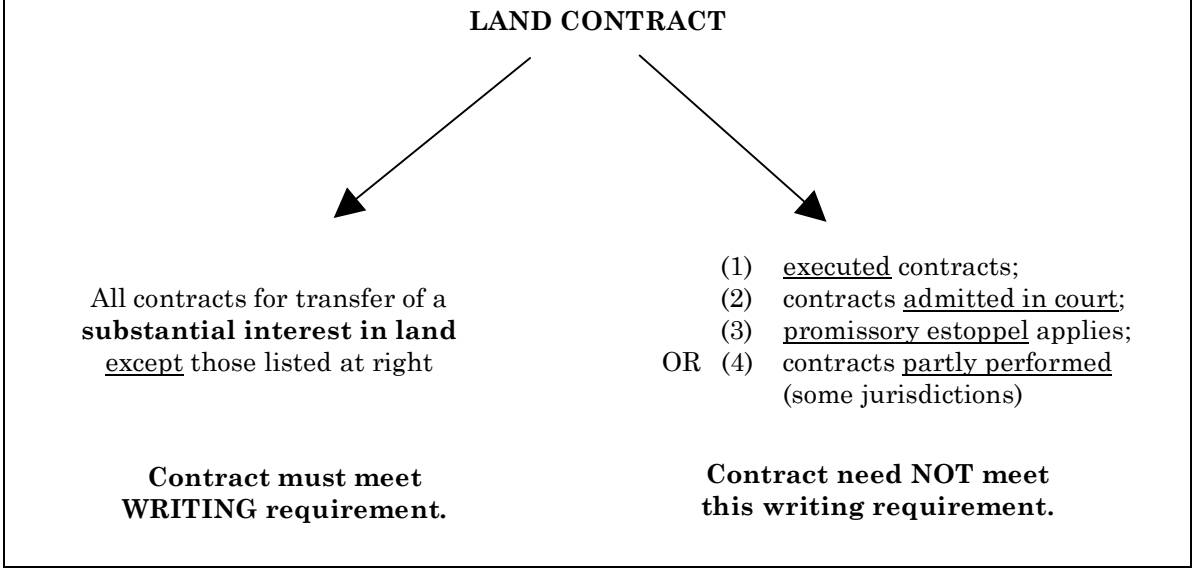
DECISION Yes, at least in some jurisdictions. Sambo has partly performed the oral land sale contract, and changed her position substantially in reliance on it.

Some jurisdictions make an exception to the general rule that contracts for the sale of land must be written where there are certain kinds of part performance by the buyer. Such jurisdictions say the contract may be enforced, even though it fails to meet the writing requirement, if the buyer has partly performed and changed her position substantially in reliance on the agreement.

In this case, the land sale contract Sambo and Chuon made was oral. However, Sambo (the buyer) partly performed by paying a large part of the sale price. And she changed her position substantially in reliance on the agreement, by taking possession of the land and building a new house on it. Therefore, in some jurisdictions, Sambo could enforce this agreement.

As noted above, different jurisdictions have different requirements for this exception. So it is important to check local law to see if the exception applies, and how it may apply.

Illustration: Contracts for the Transfer of a Substantial Interest in Land



6.3c Agreements That Cannot Be Performed Within One Year of the Time They Are Made May Be Subject to Writing Requirements

In many jurisdictions, contracts which cannot possibly be fully performed within one year of the date the contract is made must generally be written to be enforceable. This rule exists because the terms of a contract that cannot be performed within one year might easily be forgotten before the contract is completed. In that situation, it might be hard for parties and courts to enforce the contract. So the rule encourages parties to be clear about long term obligations.

However, some jurisdictions no longer apply this requirement. For example, England no longer requires this kind of contract to be written. So it is important to check the local law to see if the requirement applies.

In jurisdictions that do apply this rule, one difficult aspect of the rule is knowing whether it actually applies to a particular situation. The rule says that all contracts that cannot possibly be fully performed within one year of the date the contract is made must be written. For example, a contract for employment for five years cannot possibly be performed in only one year, so under the rule it must be written to be enforceable. However, an employment contract for the life of the employee could possibly be fully performed within one year--because the employee might die in less than a year! So this contract would not need to be written in order to be enforceable, even though it might last for many years, if the employee lived for many years. In applying this rule, what actually happens does not matter. It is the potential--at the time the contract is made--for the contract to be finished in less than one year that matters. It is also important to remember that the time in this rule is measured starting from the date the contract is made--not the date performance begins.

So in applying this rule, the important question to ask is: could the contract possibly be fully performed within one year from the date of the contract? If the answer is no, a writing is required. If the answer is yes, then no writing is required under this rule. The following two Case Studies show the difference between these two situations.

*** ***CASE STUDY 141***

FACTS Mara telephones Poong and offers him a job managing the Blue Hotel for three years, at a salary of $2,000 per year, starting in two weeks. Poong accepts the offer on the telephone.

But one week after Poong accepts the hotel's offer, he gets an offer for a better job negotiating contracts for a local textile manufacturer. Poong decides he does not want the hotel job after all. So he tells Mara he will not work for the hotel.

QUESTION OF LAW Can Mara enforce this agreement?

DECISION No. Mara cannot enforce the agreement because it is an oral agreement that cannot be performed within one year.

In many jurisdictions, contracts must be written if they cannot be fully performed within one year. In this case, Poong's agreement to work for Mara at the Blue Hotel requires more than one year for performance. In fact, it requires three years for performance. There is no way it can be fully performed before that time. Therefore, the agreement must be in writing

in order to be enforceable. But in this case, the agreement is oral. So Mara cannot enforce it against Poong.

*** ***CASE STUDY 142***

FACTS Sary has the HIV virus. Eventually he develops AIDS. Unfortunately, he becomes very ill and is unable to care for himself any more. So he asks Sieng for help. Sieng orally offers to care for Sary for "as long as Sary lives," in return for $1,000 to be paid by Sary immediately, and $1,000 to be paid by Sary at the end of each full year of care by Sieng. Sary agrees orally.

Sieng begins to care for Sary. But Sieng finds that the job is very difficult, and that he has little time to spend with his own family. After six months, Sieng decides he cannot go on with the job. So he tells Sary that he is sorry, but that he cannot care for him anymore.

QUESTION OF LAW Can Sary enforce the oral contract he made with Sieng?

DECISION Yes. Sary can enforce the oral contract with Sieng because the contract could possibly be performed within one year, so it need not be written to be enforceable.

In many jurisdictions, agreements must be written if they cannot possibly be performed within one year of the time the contract is made. In this case, Sieng agreed to care for Sary for as long as Sary lived. At the time the contract was made, it was not certain that Sary would live for one year. And whenever Sary died, Sieng would have completed his obligation to care for Sary "as long as Sary lived." In other words, the agreement between Sary and Sieng might have been completely performed within one year. Of course, the agreement might not have been completed within one year. But that does not matter. What matters is the contract's potential--at the time the contract is made--to finish within one year. In this case, the contract between Sary and Sieng had the potential to finish in less than one year.

So this contract did not need be written to be enforceable. This contract is enforceable, and a court might order money damages for Sary. A court would probably not order that Sieng actually perform this personal services contract, because of the potential difficulties in enforcing the contract, as will be discussed in Chapter 10 ("Remedies"), Section 10.7a.

Although the law does not require a writing in situations like Case Study 142, the parties in such situations would best protect their interests by putting their agreement in writing anyway. This is because the contract might last many years. After all that time, the parties may have very different ideas or memories about the terms of their agreement.

There are four exceptions to the general rule that agreements that cannot be performed within one year must be written to be enforceable. In these special situations, courts will enforce such agreements, even though they do not meet the writing requirement! These exceptions occur where:

(1) contracts are executed;

(2) contracts are admitted in court;

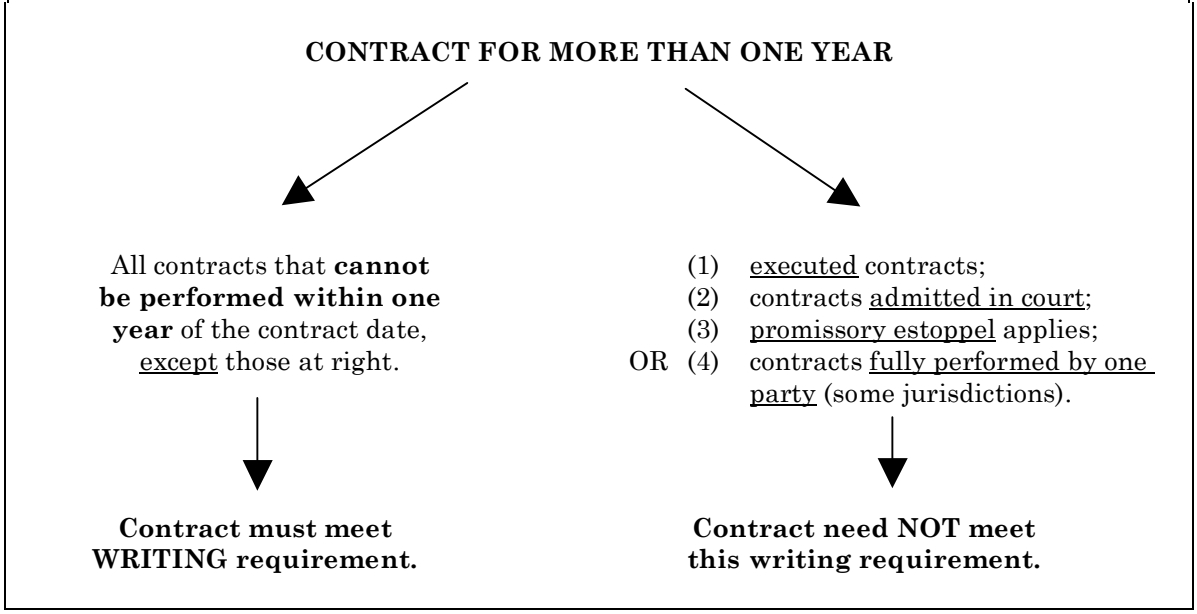
(3) promissory estoppel applies;

OR (4) contracts are fully performed by one party (in some jurisdictions).

The first three exceptions were explained in Section 6.3a, above.

The fourth exception is that some jurisdictions will enforce oral agreements that cannot be performed within one year if one party has fully performed her obligations under the contract. This is really like a "part performance" exception, since the full performance of one party is only part of the entire contract. For example, if Mara in Case Study 141 actually paid Poong the full salary due to him for the whole three year employment contract, some courts at that point would enforce the contract even though it was oral. Of course, enforcing the contract at that point would basically mean enforcing Poong's obligations, since Mara would have fully performed already. As noted above, only some jurisdictions apply this exception. So it is important to check the local law to see if the exception applies.

Illustration: Contracts That Cannot Be Performed Within One Year



6.3d Suretyship Contracts (Agreements to Become Responsible for the Debts or Obligations of Another Person) May Be Subject to Writing Requirements

Suretyship contracts must be written in order to be enforceable in many jurisdictions. The main reasons for this rule appear to be to protect the surety, and to force her to think carefully before making such an agreement.

*** **DEFINITION:** A **suretyship contract** is an agreement in which one person (the surety) agrees to become responsible for the debts or obligations owed by a second person (the debtor or promisor) to a third person (the creditor or promisee); the surety agrees to perform if the second person fails to pay the debt or meet the obligation.

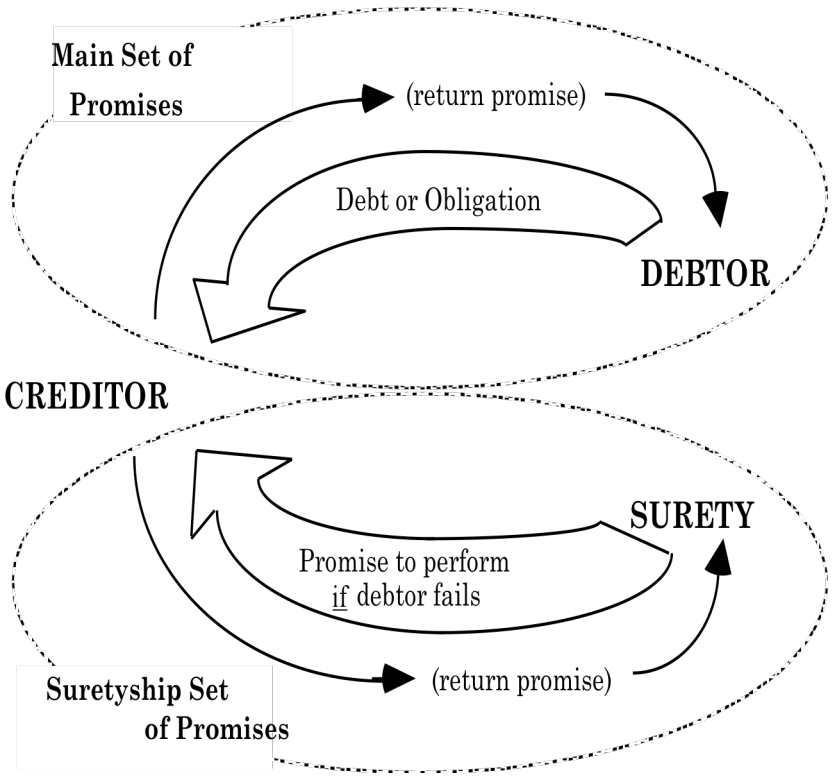
As the above definition shows, suretyship contracts can involve obligations to pay debts or do other things. To form a suretyship contract, the surety's promise must be to meet the obligation of another person--not an obligation of the surety herself. Often, the creditor makes an agreement with the debtor at least partly because the surety agrees to pay the debt or obligation if needed--that is, the surety agrees to perform if the debtor fails to do so. For example, Emma and Max may agree that Max will give Ken certain goods, and if Ken fails to pay Max for the goods, then Emma will pay for them. That is a suretyship agreement.

In these situations, there are really two sets of promises: (1) the main set of promises between the debtor and the creditor; and (2) the suretyship set of promises between the surety and the creditor. It appears that these sets of promises can exist all in one agreement, or that the two sets can be separate agreements. Some jurisdictions distinguish between suretyship contracts and guarantee contracts. These jurisdictions appear to say that suretyship contracts generally occur where all the parties join in the same agreement, whereas guarantee contracts occur where the guarantor and creditor have an agreement separate from the main agreement between the creditor and debtor. Other jurisdictions seem to include both of the above arrangements within the term "suretyship contracts." That is the approach of this text.

In any case, the following chart shows basically how suretyship contracts work.



Illustration: How Suretyship Contracts Work



The general rule that suretyship agreements must be written to be enforceable is illustrated in the following Case Study.

*** ***CASE STUDY 143***

FACTS Narann has a daughter named Dany who is very intelligent and hard working. Dany wants to attend university. However, her family is poor and cannot afford the university fees.

One day, Narann orally tells a money lender named Vanna that if Vanna will agree to lend $500 to Dany to help her pay the university fees, then Narann will agree to repay the money if Dany fails to do so. Vanna agrees. He loans Dany the money, in exchange for Dany's promise to repay the debt and Narann's promise to guarantee the debt. Dany fails to repay any of the money.

QUESTION OF LAW Can Vanna enforce the agreement he made with Narann and recover the money from her?

DECISION No. Vanna cannot enforce the suretyship agreement with Narann because it was oral.

Suretyship agreements must generally be written to be enforceable. In this case, Narann promised to be responsible for the debt to be owed

by another person (her daughter Dany) to a creditor (Vanna). This made Narann a surety. But Vanna failed to put the suretyship agreement in writing. Therefore, it is not enforceable. Of course, Vanna can still enforce the main loan agreement against Dany.

One important example of a suretyship agreement that must be written to be enforceable is an agreement of an executor or administrator of the estate of a deceased person to pay the debts of the estate from the executor's or administrator's own personal funds.

*** **DEFINITION:** An **executor or administrator of an estate** is someone who gathers the assets of a recently deceased person, pays the debts of the deceased person from those assets, and then distributes what remains to the legal heirs.

In general, executors resolve the affairs of those who leave wills, while administrators resolve the affairs of those who die without wills. For ease of discussion, this text will refer only to executors from this point forward.

The executor of an estate is not normally obligated to pay the debts of the deceased person from the executor's own personal funds. So a promise to pay the debts of the estate from personal funds of the executor is actually an agreement to become responsible for the debts of another--a suretyship contract. Therefore, such an agreement, like other suretyship contracts, generally must be in writing in order to be enforceable. In this way, the law tries to prevent creditors from holding executors personally responsible for the debts of the estate. It also tries to make executors think carefully before they agree to pay such debts from their own personal funds.

*** ***CASE STUDY 144***

FACTS Mono is a soldier whose nation is at war. Mono owes Samneang $100, along with 5% per year in interest on that amount. But before Mono can repay this debt, Mono unfortunately dies fighting for his country.

After Mono's death, Pheara becomes the executor of Mono's estate. Samneang contacts Pheara to say that she is very sorry to hear about Mono's death, but that she wonders when she will be paid the $100 plus interest that Mono owes her. Pheara tells Samneang that the estate has many debts, and it is not clear if they will all be paid. Pheara also tells Samneang orally that, if Samneang will agree to wait six more months for the money and agree to not ask for any more interest, then Pheara will pay the debt from her own personal funds, if there is no money available in Mono's estate. Samneang agrees.

QUESTION OF LAW Can Samneang enforce this oral agreement?

DECISION No, Samneang cannot enforce this agreement because it is an oral agreement of an executor (Pheara) to pay the debts of an estate from the executor's personal funds.

In general, agreements by executors to pay the debts of a deceased person's estate from personal funds must be written to be enforceable. This is because such agreements are really suretyship agreements, in which the executor agrees to be responsible for the debts of another person.

In this case, after Mono died, his executor Pheara agreed to become responsible for Mono's debt to Samneang--to pay the debt from Pheara's own personal funds if there was no money left in the estate to pay it. But this agreement was oral. Therefore, it cannot be enforced against Pheara.

There are four exceptions to the general rule that suretyship contracts must be written to be enforceable. In these special situations, courts will enforce such agreements even though they do not meet the writing requirement. These exceptions occur where:

(1) contracts are executed;

(2) contracts are admitted in court;

(3) promissory estoppel applies;

OR (4) there are contracts whose main purpose is the surety's own financial benefit.

The first three exceptions have already been explained in Section 6.3a, above.

The fourth exception is that a suretyship agreement that fails to meet the writing requirement is enforceable if its main purpose is to financially benefit the surety herself. This may occur even though the effect is still that the surety agrees to pay the debt of a different person (the debtor). The following Case Study illustrates this possibility.

*** ***CASE STUDY 145***

FACTS Vantha is a young business person who plans to open a big new factory to produce high quality condoms. Vantha makes a contract with the Modern Machine Company to have some modern machines made for her new factory.

In order to make these machines for Vantha, the Modern Company needs to continue to get supplies from the Strong Metal Company for several months. Vantha wants to make sure the Modern Company gets these supplies, so her new factory can open on time. So Vantha orally agrees with the Strong Company that if the Strong Company continues to deliver the supplies to the Modern Company, and the Modern Company fails to pay for them, then Vantha will pay for the supplies herself. Eventually,

the Modern Company does fail to pay the Strong Company for some of these supplies.

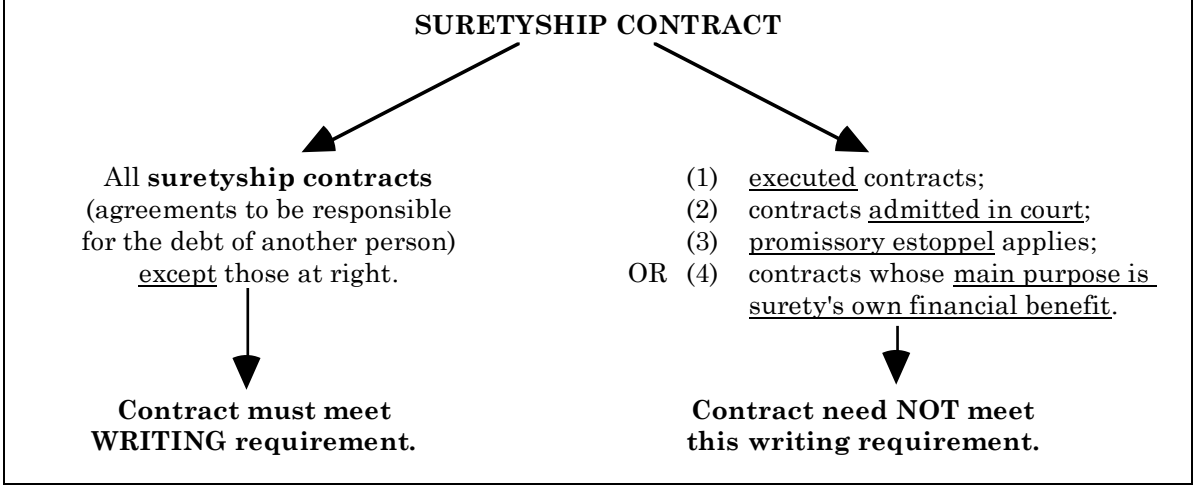
QUESTION OF LAW Can the Strong Company enforce this oral agreement against Vantha?

DECISION Yes. The Strong Company can enforce its oral suretyship agreement with Vantha because the main purpose of the agreement was to benefit Vantha financially.

If the main purpose of a suretyship agreement is to benefit the surety financially, then the agreement need not be written to be enforceable. This is an exception to the general rule about suretyship agreements.

In this case, Vantha agreed orally to pay for the supplies the Strong Company would deliver to the Modern Company--to be responsible for the debt of another--in order to make sure the machines that the Modern Company was making would be ready for her own new condom factory. So Vantha's main purpose in making the agreement was her own financial benefit, not helping the Modern Company. This contract was not required to be written. So the Strong Company can enforce it against Vantha.

Illustration: Suretyship Contracts



6.3e Agreements in Which the Promise of One Person Is Made in Exchange for Marriage or a Promise to Marry May Be Subject to Writing Requirements

In some jurisdictions, an agreement in which one person promises to do something in exchange for marriage or a promise to marry must generally be in writing to be enforceable. For example, an agreement to marry someone in exchange for $300 must be written to be enforceable. This writing requirement also applies to promises to marry someone who is not a party

to the contract. However, as will be discussed below, this writing requirement does not apply to agreements that are no more than mutual promises to marry.

One reason for these rules may be to protect the parties to such important agreements. Another reason may be that, when a person marries for material reasons, or other reasons besides affection for her spouse, the law in many jurisdictions wants the parties to think carefully about whether that is a wise decision. The writing requirement promotes these goals.

However, it appears that many jurisdictions no longer have this requirement. And as discussed in Chapter 5 ("Legality"), Section 5.4c, many jurisdictions do not enforce agreements to marry! Even where such agreements are enforceable, it appears that modern courts would not actually order anyone to marry against her will. Courts in some jurisdictions may order a party to provide some monetary remedy because of an agreement to marry. So it is important to check the local law in this area.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.4c contains further discussion of the legality of different kinds of contracts related to marriage.

*** ***CASE STUDY 146***

FACTS Bunna orally promised his daughter Boroth that he would transfer to Boroth his big pink villa beside the Tonle Sap if she married Samrach. Boroth agreed orally, and married Samrach. After the marriage, Bunna refused to give his daughter the villa he had promised. So she sued him in court.

QUESTION OF LAW Can Boroth enforce this contract against her father?

DECISION No. Boroth cannot enforce the agreement with Bunna because it is not in writing.

In many jurisdictions, contracts in which one party promises to do something in exchange for the other party's marriage or promise to marry must generally be written to be enforceable, unless they are no more than mutual promises to marry. In this case, Boroth and Bunna agreed that Bunna would give Boroth the villa, and in exchange Boroth would marry Samrach. But Bunna's promise was not in writing. So it cannot be enforced against Bunna.

There are four exceptions to the general rule that contracts in which the promise of one person is made in exchange for marriage or a promise to marry must be written to be enforceable. In these special situations, courts will

enforce such agreements even though they do not meet the writing requirement. These exceptions occur where:

(1) contracts are executed;

(2) contracts are admitted in court;

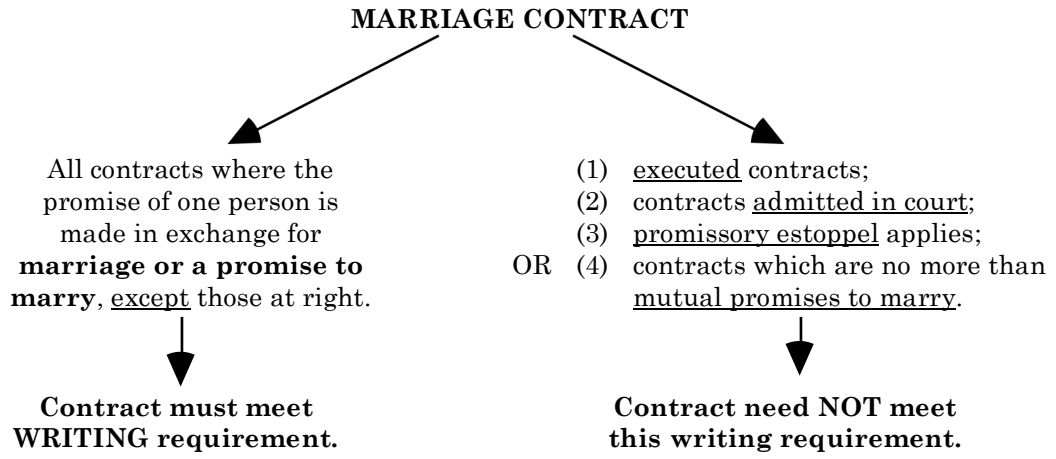
(3) promissory estoppel applies;

OR (4) contracts are no more than mutual promises to marry.

The first three exceptions were explained in Section 6.3a, above.

The fourth exception is that no writing is required for contracts which are actually no more than mutual promises to marry--where two parties simply agree to marry each other--and there is no exchange of money, property, or other consideration. For example, in Case Study 146 above, if Boroth and Samrach had simply promised orally to marry each other, that agreement would not have been subject to a writing requirement. But if anything besides those promises was involved--as actually happened in Case Study 146--then many jurisdictions would require the agreement to be written in order to be enforceable.

Illustration: Marriage Contracts



6.3f Agreements for the Sale of Goods over a Certain Monetary Amount May Be Subject to Writing Requirements

In many jurisdictions, contracts for the sale of goods of more than a certain monetary amount must generally be written to be enforceable. For example, in jurisdictions in the United States, an agreement for the sale of goods of $500 or more generally requires a sufficient writing in order to be enforceable. In France, it appears that contracts for "any thing" over 5,000 francs generally must be written to be enforceable, although there are some broad exceptions.

*** ***CASE STUDY 147***

FACTS Sovandara's new job at the Ministry requires him to buy a fleet of vehicles for the Ministry. Sovandara searches carefully for the right vehicles. Finally, he orally agrees to buy 10 automobiles from Mom Thol for $100,000.

Unfortunately, when the time comes for Mom Thol to deliver the automobiles, Mom Thol fails to do so. Mom Thol says that the automobiles will now cost Sovandara $120,000. Sovandara asks the court to enforce the agreement.

QUESTION OF LAW Can Sovandara enforce this agreement?

DECISION No. The parties failed to put their agreement in writing, so it cannot be enforced.

In many jurisdictions, agreements for the sale of goods over a certain amount must generally be in writing to be enforceable. In this case, the sale of goods contract between Mom Thol and Sovandara for the cars was for $100,000. This amount is far above the amounts that the laws of many jurisdictions specify for sale of goods contracts that must generally be written to be enforceable. However, in this case, there was no writing recording the agreement of Sovandara and Mom Thol. Their agreement was oral. So the agreement cannot be enforced.

In many jurisdictions, there are five exceptions to the general rule that contracts for the sale of goods over a certain amount must be written to be enforceable. In these special situations, courts will enforce such agreements even though they do not meet the writing requirement. These exceptions occur where:

(1) contracts are executed;

(2) contracts are admitted in court;

(3) promissory estoppel applies;

(4) contracts have been partly performed (enforceable to the extent of the part performance);

AND (5) contracts are for specially manufactured goods.

The first three exceptions were explained in Section 6.3a, above.

The fourth exception, which applies in many jurisdictions, says that sale of goods contracts that fail to meet the writing requirement are enforceable to the extent that payment has been made and accepted, or the goods have been received and accepted. This basically means that such contracts are enforceable to the extent that they have been partly performed, as long as the party receiving the performance has "accepted" it.

For example, suppose a buyer makes an oral agreement to buy 100 kilos of rice. If the buyer receives and accepts 10 kilos, a court would enforce the contract to the extent of the performance--the 10 kilos that were received and accepted. In general, this would appear to mean that the court would order the buyer to provide a remedy based on having the duty to pay 1/10 of the purchase price, since she received and accepted 1/10 of the rice in the oral contract.

The fifth exception, which also applies in many jurisdictions, says that a seller may be able to enforce an agreement for the sale of specially manufactured goods that fails to meet the writing requirement. Specifically, many jurisdictions say that a seller can enforce such an agreement if:

(1) the goods are to be specially manufactured for the buyer;

(2) the goods are not suitable for sale to others in the ordinary course of the seller's business;

AND (3) the seller has made a substantial start on making the goods, or a commitment to get the goods, before the buyer repudiates the contract.

The purpose of this exception is to protect sellers of such goods when it is too late to do anything useful with the goods except sell them to the buyer who originally asked for them.

*** ***CASE STUDY 148***

FACTS Heang owned a very popular restaurant in Battambang called Happy Heang's Restaurant. Heang made an oral agreement with Happy Sambath's Glass Factory. Under the agreement, Sambath would manufacture and sell to Heang 2,000 special glasses, each with the special "Happy Heang's Restaurant" logo in blue and red, for 1,000 riels per glass.

However, after Sambath had created the design and made about half of the glasses, Heang decided he did not really want the glasses after all. So he told Sambath he would not go through with the agreement. Sambath asks the court for help.

QUESTION OF LAW Can Sambath enforce this oral agreement?

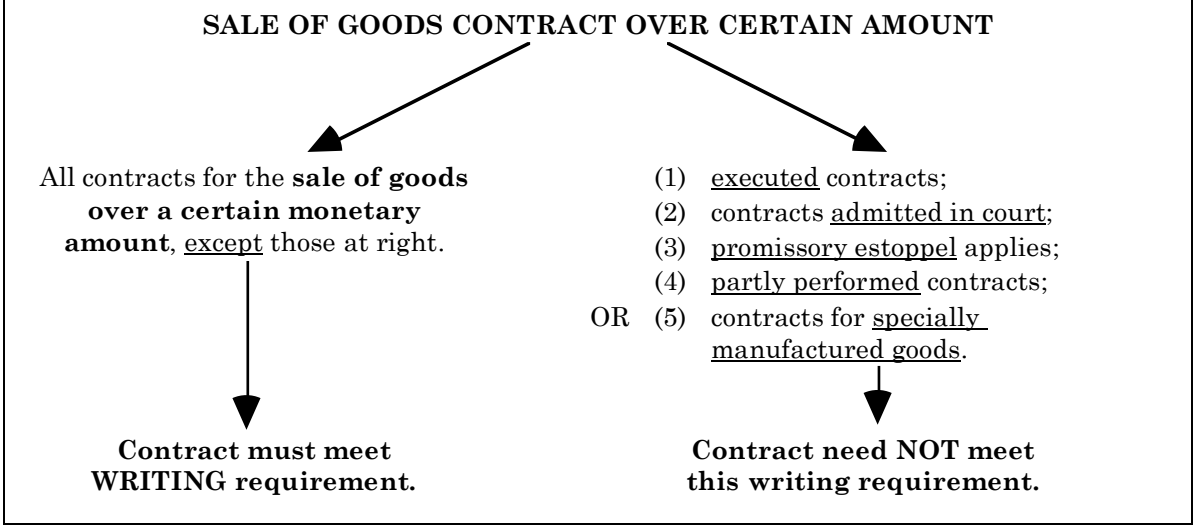
DECISION Yes. In many jurisdictions, Sambath could enforce this oral agreement for the sale of goods because of the exception for specially manufactured goods.

The laws of many jurisdictions require that contracts for the sale of goods over a certain amount be written to be enforceable. But this is not required, in many jurisdictions, if the goods are to be specially manufactured for the buyer, the goods are not suitable for sale to others in the ordinary

course of business, and the seller has made a substantial start on making the goods before the buyer repudiates the contract.

In this case, Happy Sambath had an agreement to make 2,000,000 riels worth of "Happy Heang" glasses for Happy Heang. Normally, many jurisdictions would require that this agreement be written to be enforceable. But in this case, the glasses were to be specially manufactured for Heang's restaurant; they were not suitable for sale to anyone else, with Heang's special design on them; and Sambath had made a very substantial start at making them before Heang told Sambath that he would not go through with the contract--since Sambath had already designed the glasses and actually made half of them! Therefore, all the requirements for the "specially manufactured goods" exception are met. So in this special situation, Sambath can enforce the contract even though it is oral.

Illustration: Contracts for the Sale of Goods over a Certain Amount



6.3g Other Contracts Some Jurisdictions Require to Be Written

The five types of contracts discussed in Sections 6.3b-f are not the only contracts that must be written in order to be enforceable in free market jurisdictions. In fact, most jurisdictions also require that various other kinds of important contracts be written.

There are many types of contracts which statutes in different jurisdictions may require to be written. A few examples are:

(1) contracts for the sale of securities;

(2) agreements to pay commissions to real estate brokers;

(3) agency agreements under which a principal authorizes an agent to execute contracts which themselves are required to be written;

(4) promises to pay debts which could not otherwise be enforced because of statutes of limitations; and

(5) promises to pay debts already discharged in bankruptcy.

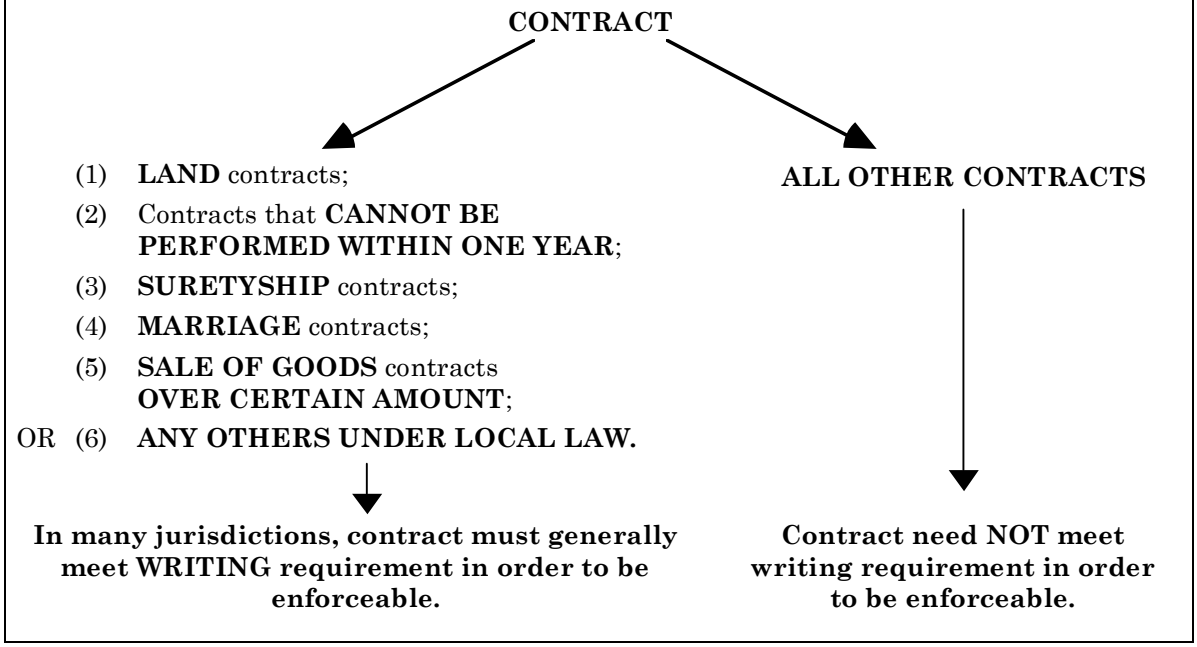
As readers may recall, these last two examples are also exceptions to the general requirement that consideration exist for promises to be enforceable in common law jurisdictions. Although no consideration is required in these situations, the law does want to be sure that parties think carefully about such promises before they make them--as with all other promises where the law requires a writing.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.8b contains a more complete discussion of promises to pay debts already discharged in bankruptcy, and Section 3.8d discusses promises to pay debts which could not otherwise be enforced because of statutes of limitations.

6.4 Summary of Some Basic Rules about Contracts That Many Jurisdictions Generally Require to Be Written

As discussed above in Section 6.3, although contracts generally need not be written in order to be enforceable, certain types of contracts must generally be written to be enforceable in many free market jurisdictions. Below is a chart that summarizes some of the basic rules about such contracts.

Illustration: Some General Rules about Contracts That Must Be Written



Of course, as discussed in Section 6.3, there are some exceptions to the general rule that the types of contracts specified above must be written. These exceptions say that, in certain situations, even contracts in these categories need not be written in order to be enforceable. The chart below summarizes some of these exceptions.

Illustration: Exceptions to Rules about Contracts That Must Be Written

	TYPE OF CONTRACT				
EXCEPTIONS –	Marriage	Surety-ship	Not in One Year	Interest in Land	Sale of Goods
Mutual Exchange of Promises to Marry	Need Not Be Written				
Main Purpose to Benefit Surety		Need Not Be Written			
Part Performance			Need Not Be Written	Need Not Be Written	Need Not Be Written
Specially Manufactured Goods					Need Not Be Written
Contract Executed	Need Not Be Written	Need Not Be Written	Need Not Be Written	Need Not Be Written	Need Not Be Written
Contract Admitted in Court	Need Not Be Written	Need Not Be Written	Need Not Be Written	Need Not Be Written	Need Not Be Written
Promissory Estoppel Applies	Need Not Be Written	Need Not Be Written	Need Not Be Written	Need Not Be Written	Need Not Be Written

6.5 Modifications of Contracts Are Subject to the Same Writing Requirements as the Original Contracts Were

Sometimes parties to a contract the law requires to be written seek to change terms of their original agreement after the contract has been written. When parties modify such a contract, they are really making a new contract. So the basic formula in this situation is:

Provisions from Old Contract + Modification(s) = NEW CONTRACT

This new contract must be in writing in order to be enforceable if it is a contract that the law would otherwise require to be written. This is because the writing requirement applies to the new contract in the same way as it applied to the old contract.

*** ***CASE STUDY 149***

FACTS Vouch Lim is a tycoon who owns hotels in several major Cambodian cities. To supply all of her many hotel guests, Vouch Lim makes a written contract with a soft drink tycoon named Thida. This contract provides

that Vouch Lim will purchase from Thida 1,000 cases per month of a popular soft drink, for 24 months, for the price of 10,000 riels per case.

After 10 months, Vouch Lim decides that her business requires an additional 500 cases each month. Vouch Lim telephones Thida, who is on holiday in Kampot. Together they agree orally that Thida will deliver 1,500 cases (instead of only 1,000 cases) to Vouch Lim each month for the remaining 14 months of the contract.

But soon Thida realizes that she is not able to deliver that much. She tells Vouch Lim that she cannot perform the new agreement. Vouch Lim seeks to enforce the new agreement.

QUESTION OF LAW Can Vouch Lim enforce the new agreement for the additional 500 cases of soda?

DECISION No. The new agreement between Vouch Lim and Thida cannot be enforced because it failed to meet a writing requirement.

The new agreement is a contract for the sale of goods over the statutory amount in many jurisdictions, and also a contract which cannot be performed within one year. Therefore, the new agreement requires a writing containing the new terms. But in this case, the new agreement Thida and Vouch Lim made on the telephone was oral. So the new agreement cannot be enforced. Of course, the original written contract for the sale of the 1,000 cases per month can still be enforced.

6.6 What the Law Requires for a Sufficient Writing

When the law requires a contract to be written, it also requires that the writing be in a certain form in order to be sufficient. In fact, if a contract is written but does not contain what the law requires, it may still be unenforceable--as if it was not written at all! So it is very important to know not only which contracts must be written, but also what the law requires for a sufficient writing.

6.6a The Law Is Flexible about the Physical Form of the Writing

First of all, it is important to understand the physical form the writing may take. The "writing" is generally defined broadly, and many different physical forms are acceptable. The writing may be a formal document hundreds of pages long. But it may also be a short letter, a check, a receipt, or simply a note. And as technology makes available new ways to communicate by writing--such as through electronic mail--new forms will likely become acceptable.

In addition, the writing need not be only one document. In fact, the writing requirement may be satisfied by several writings. For example,

the requirement may be satisfied by a series of letters or notes between the parties, as in many of the Case Studies in this text, such as Case Studies 84-86. This flexibility is especially important in sale of goods contracts like those in Case Studies 84-86, where the parties may not have time to create one formal writing. In that situation, the parties may simply rely on a series of forms or acknowledgments sent between them.

6.6b The Law Is Flexible about the Circumstances under Which the Writing Is Created

It is also important to understand the rules about the circumstances under which the writing may be created. In general, the requirements of the law are not strict in this area either.

The law is flexible about why the writing is created, and who actually receives it. In fact, in many jurisdictions, the writing does not even need to be created for the purpose of recording the agreement. And there is no requirement that the party seeking to enforce the contract have ever seen the document!

For example, suppose two companies make a sale of goods agreement that fails to meet a writing requirement in the usual way (a written agreement signed by the parties). However, one party may still be able to enforce the agreement, using other documents that show there actually was an agreement. One way to do this might be to use an internal company memorandum from one employee to another employee at the seller's company asking the second employee to fill the order for the goods. This may be true even though the memorandum was not created for the purpose of recording the contract, and even though the party outside the company may have never seen the memorandum before going to court!

As for when the writing may be created, the law says that it need not be made at the time of the parties' agreement. It need be in existence only at the time a party seeks to enforce the contract, as the internal memorandum in the example above was. So a sufficient writing could be created much later than the time the parties actually agree about the terms of the contract--after the parties start to perform the contract, or even after a lawsuit about the contract has begun! In fact, as discussed in Chapter 3 ("Consideration"), Section 3.8e, a party may make a new written promise to meet obligations which were unenforceable before because of a failure to meet a writing requirement. Such new promises do not require new consideration to be enforceable. So if a party makes an oral agreement that is unenforceable because of failure to make a sufficient writing, but the party later signs a sufficient writing, the contract becomes enforceable against that party as soon as the writing is made!

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.8e contains further discussion of new promises to perform under contracts

that were previously unenforceable because of a failure to meet a writing requirement.

6.6c The Writing Must Contain the Essential Terms of the Contract

Finally, although as noted above the law is flexible about some aspects of the writing requirement, the law is more strict about what words the writing must actually contain in order to be sufficient. The laws of different jurisdictions have different requirements about this. So as always, it is important to check the local law relevant to any transaction.

(1) General Rules

Basically, where there is a writing requirement, the writing must contain at least every essential term of the parties' agreement. More specifically, many jurisdictions say a writing requirement is met--and the contract is enforceable--if the writing contains at least the following:

(1) the essential terms of the contract that have not yet been performed, including a reasonable identification of the subject matter of the contract;

(2) the identities of the parties; and

(3) the signature of the party against whom the contract is being enforced or her agent.

Of course, as discussed above, the writing can be much more brief and basic than what is usually considered a formal written contract.

Sometimes it may not be easy to determine whether a writing meets certain parts of the above requirements about what the writing must contain. So we will examine some of these parts more closely.

First, the "essential terms" of the contract must be included in the writing. What terms are essential will differ to some extent in every contract. However, the requirement generally means the terms that are essential for the parties to understand--and the court to enforce--the contract. For example, in an employment contract for a specific time longer than one year, the essential terms would probably be the starting and ending dates of the contract, the compensation to be paid to the employee, and some description of the job of the employee. Other terms might also be essential, depending on the particular situation. This was discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b, which explained the requirement that a valid offer contain the truly essential terms of the proposed contract.

One term which many jurisdictions say will always be essential is a "reasonable identification of the subject matter." This basically means a description of what the contract is about that is sufficient for the parties

to understand it. For example, a written contract in which Saray agrees to pay $5,000 to Kim Srong in exchange for "the green car at Kim Srong's house" is probably sufficient, as long as both parties understand what it means. Of course, it is usually better to describe the subject matter much more carefully, to make sure there can be no dispute about what it means.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b contains a more complete discussion of what terms may be essential in different kinds of contracts, and the requirement that the material terms in a contract be definite and reasonably clear.

The requirement of the "signature" of the party against whom the contract is being enforced basically means some writing or mark that shows the party has actually made the agreement. The "signature" could be a stamp, a special symbol, a nickname, or many other things. In fact, some courts have even said that the letterhead on stationery can be a sufficient "signature!"

The other important aspect of the signature requirement is that courts will enforce the contract against a party who signed the writing--even if the other party did not sign! For example, Phally and Sarun may agree orally that Sarun will buy a certain piece of land from Phally. Suppose Phally signs the written contract recording this transaction, but Sarun does not. In this situation, Sarun could enforce the contract, but Phally could not if Sarun did not admit to making the contract. The reason for this rule is that the party seeking to enforce the contract--Sarun in this example--is actually confirming that he has agreed to the contract by going to court. So his signature is not really needed. But it would often be unfair to enforce a contract that must be written against someone who never signed it and does not admit to making it. That could (and often does) mean that the party never actually agreed to the contract. A contract in this situation appears to be like a voidable contract in the sense that one party (the party who did not sign the writing) could choose not to proceed with it, and in that case the other party could not force her to do so.

*** ***CASE STUDY 150***

FACTS Ann wants to start a business to sell bicycles, so he can earn money and also reduce air pollution in the city. He starts to look for a suitable shophouse for his new business.

After a few days, Ann orally agrees to buy Mony's shophouse and land for $2,000. Ann gives Mony a $100 down payment on the shophouse, and Mony writes the following note for Ann:

"Received from Ann $100 as down payment for purchase of Mony's shophouse and land at 77,777 Monivong Blvd. by Ann. Balance due: $1,900."

Both Ann and Mony sign the note.

Unfortunately, there is later a dispute about the agreement. Mony returns the money, claiming there is no contract because there is no sufficient writing. Ann asks the court to enforce the contract.

QUESTION OF LAW Is this note sufficient to create an enforceable contract between Mony and Ann?

DECISION Yes. The note Ann and Mony signed is sufficient because it meets all the writing requirements for a contract for the sale of real estate.

In general, where a contract must be written, the writing must contain at least the essential terms, including a reasonable description of the subject matter, the identities of the parties, and the signature of the party against whom the contract is being enforced. In this case, the note Mony and Ann signed about the sale of Mony's shophouse meets all these requirements. The parties are stated (Mony and Ann); the essential terms are included (the sale of Mony's shophouse and land at 77,777 Monivong Blvd. to Ann for $2000); and the parties (Mony and Ann) have signed the note. So the writing requirement has been met here, even though the note is brief and informal. The contract is enforceable.

Of course, it is usually wise for parties to make the writing more complete, in order to protect their interests, and avoid disputes and confusion. In fact, if parties fail to include a term of their agreement in the writing, they may have difficulty enforcing that term--or be unable to do so at all! In common law jurisdictions, this is partly because of the important "parol evidence rule" which will be discussed in Chapter 8 ("Interpretation of Contracts"). So although a very brief note may satisfy the writing requirement for a contract to be enforceable, it is usually better--and safer--to create as complete a document as possible.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.4b discusses the parol evidence rule, which many common law jurisdictions use to determine the status of terms which are not included in the writing that records a contract.

(2) Sale of Goods Contracts

As noted above, some jurisdictions require less for writings of sale of goods contracts than they require for other types of contracts. For example, the Uniform Commercial Code in the United States says that for sale of goods contracts subject to the writing requirement, the writing must contain three things in order for the contract to be enforceable:

(1) the identity and quantity of goods;

(2) language sufficient to indicate that a contract has been made between the parties;

AND (3) the signature of the party against whom the contract is being enforced or her agent.

This law does not require that the writing include terms such as time or place of payment or delivery, the general quality of the goods, warranties or even price. This is because courts can generally supply (or imply) this information from other sources, such as market conditions, trade customs and practices, and the course of dealing between the parties. Of course, a well-drafted contract would probably include most or all of this information, in order to avoid disputes and protect the parties.

This rule does require that the writing contain at least the quantity of goods, and courts will not enforce the contract beyond the quantity of goods stated in the writing. For example, if a person makes an oral sale of goods contract to buy 10 tractors, but the writing recording the agreement says only 8 tractors, the party can only enforce the agreement for 8 tractors.

In addition, what will be a "sufficient" writing to show that parties actually made a contract could vary a great deal in different situations. It seems that there should be at least some indication of who is making the contract, and the fact that those persons actually have an agreement. For example, a writing that simply said "agreed 8 of Sovann's tractors for Pal Chuon" might meet this requirement. But a writing that said only "8 tractors" might not meet the requirement.

The "signature" requirement is basically the same for sale of goods contracts as it is for other contracts. However, there is one exception in some jurisdictions, such as Germany and the United States. This exception basically applies where both parties are merchants, the merchants make a sale of goods agreement that is not written, and a signed written confirmation is sent by one merchant and received by the other merchant. The exception says that this confirmation creates a contract that can be enforced against either merchant--including the one who did not sign--unless the non-signing merchant objects within a specified short time after receiving the confirmation. For example, in the United States, this time is 10 days.

This exception helps parties create more sale of goods contracts more quickly and easily. It also limits the ability of the non-signing merchant to "play the market." The merchant might do that because in this situation she would have the option to perform the contract or not. So she could wait to see if market conditions at the time of performance made it profitable for her to perform or not. To allow this might be unfair to the merchant who did sign the writing.

***	***CASE STUDY 151***	**(U. S. commercial code)**

FACTS Sin and Tech meet at a restaurant. Sin agrees to purchase three Cam-Pack Z-100 computer systems from Tech for $1,000 per system.

As evidence of their agreement, Sin and Tech prepare a writing on a small scrap of paper. The writing states that Tech will provide the three computer systems to Sin for $3,000. Sin signs the piece of paper.

But later Sin decides that he does not wish to buy that type of computer. He tells Tech he does not have to perform the contract because there is no sufficient writing. Tech tries to enforce the agreement.

QUESTION OF LAW Is the writing sufficient for Tech to enforce the agreement?

DECISION Yes. Tech can enforce the agreement because the writing is sufficient for a sale of goods contract.

A sale of goods contract over a certain monetary amount generally requires a sufficient writing in order to be enforceable. Because the agreement between Sin and Tech is for the sale of goods (computers) for $3,000--an amount higher than the statutory amount in many jurisdictions--the agreement must generally be in writing to be enforceable. And in this case, the parties' agreement is in writing.

But even if such an agreement is written, the writing must still be sufficient, or the agreement cannot generally be enforced. For a writing of a sale of goods contract to be sufficient, many jurisdictions simply require that the writing contain three things: the identity and quantity of goods; language sufficient to show the parties made a contract; and the signature of the party against whom the contract is to be enforced. In this case, the contract of Sin and Tech satisfies these requirements because it contains the identity and quantity of goods (three Cam-Pack Z-100 computer systems); sufficient evidence of a contract (the statement that Tech will sell the computers to Sin); and the signature of the party against whom the contract is being enforced (Sin). So this contract is enforceable against Sin.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b discusses the general requirement that offers (and contracts) be definite and reasonably clear, and the less strict rules some jurisdictions have for sale of goods contracts.

6.7 Effect of Failure to Meet a Writing Requirement: the Agreement Is Generally Unenforceable, but There Are Limits on that Rule

As discussed above, the general effect of a failure to meet a writing requirement is that the agreement is unenforceable. In fact, statutes in some jurisdictions state that these contracts are void.

However, in many jurisdictions, such agreements are not always void, because of the many limits on the general rule which are discussed in Sections 6.3-6.6, above. These limits can mean that some such agreements may

basically be valid, or that they can be enforced by one party. In addition, restitution is generally available even where such an agreement is unenforceable. And in limited situations, promissory estoppel may apply.

In many jurisdictions, agreements that fail to meet writing requirements can be enforced by either party--and so are basically valid--in a fairly large number of different situations. For example, as discussed in Sections 6.3 and 6.4, this is the case if the agreements are fully executed, or if both parties admit in court that they exist. By contrast, "void" agreements such as most illegal agreements cannot generally be enforced, regardless of whether they are executed or admitted in court. Of course, as explained in Chapter 5 ("Legality"), Section 5.5, there are a few situations where illegal agreements can be enforced.

Moreover, in many jurisdictions, agreements that fail to meet writing requirements may be enforced by one party. That could make them comparable to voidable in certain situations, since one party would basically have the choice of proceeding or not proceeding with the contract. For example, as discussed above in Section 6.6, where a writing is signed by one party but not the other party, the effect is that the non-signing party can enforce the agreement, but the signing party cannot enforce it if the non-signing party does not admit to the agreement. In addition, if one party admitted in court that such a contract was made but the other party did not, that would also appear to give the party who did not admit to the contract the option to proceed or not proceed with it.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3a contains further discussion of valid, voidable, and void agreements; and Chapter 5 ("Legality"), Section 5.5 discusses the few situations where parties may be able to enforce illegal agreements.

In addition, even if an agreement is not enforceable because of a failure to meet a writing requirement, the parties can still generally recover restitution. That would basically be the reasonable value of anything one party provided to the other party because of the agreement. This rule is similar to the one that says parties who disaffirm contracts must generally provide restitution of anything they have received, as explained in Chapter 4 ("Capacity"). The basis for this kind of recovery is quasi-contract, which aims to prevent unjust enrichment, as explained in Chapter 1 ("Basic Aspects of Contract Law") and other Chapters.

*** ***CASE STUDY 152***

FACTS Sophat orally promises to marry Samen in exchange for Samen's oral promise to marry him and pay him total of $1,000. They agree that the money will be paid in installments of $100 per month in the 10 months before the marriage.

After two months have passed, and Samen has paid Sophat $200, Sophat decides he does not wish to marry Samen after all. Sophat says he has found someone who will pay him $2,000 to marry her, and so he no longer needs Samen.

QUESTION OF LAW Can Samen recover the $200 she has paid Sophat even though she cannot enforce the oral agreement?

DECISION Yes. Samen can recover the money because parties in this situation can generally get restitution of what they have already given to the other party under the agreement.

In general, parties can get restitution where a contract is not enforceable because of a failure to meet a writing requirement. In this case, Samen and Sophat made an oral agreement which was a promise of marriage in exchange for a promise to pay money and to marry. This agreement is not enforceable in many jurisdictions, because such agreements must generally be written to be enforceable. However, parties can generally get restitution of what they have given to the other party in situations like these. So Samen can recover the $200 she gave to Sophat.

Finally, as discussed in Section 6.3a, a party may in limited situations use the doctrine of promissory estoppel where there is a failure to meet a writing requirement. Common law courts apply promissory estoppel where one party justifiably relies on a promise and that party will suffer an unjust loss if the promise is not enforced, even though there is no enforceable contract. In the case of a failure to meet a writing requirement, the most obvious example of how this could occur would be situations like the one discussed in Section 6.3a. That was the Case Study 175 situation, where a party justifiably relied on his parents' promises to transfer their farm to him, even though there was no writing. Other potential examples of situations where promissory estoppel might be appropriate include where one party falsely tells the other party that there is no writing requirement, or that a writing will be created later, or that the party will not use the lack of a sufficient writing as a defense in court. In situations like that, the other party might justifiably rely on the first party's promise and suffer an unjust loss if the promise is not enforced. But as noted earlier, courts use promissory estoppel only in limited situations where the reliance really was justified, and the potential loss really would be unjust.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains a more complete discussion of quasi-contract; Chapter 4 ("Capacity") discusses the availability of restitution when parties disaffirm voidable contracts; Chapter 7 ("Other Contract Formation Problems"), Section 7.8 explains promissory estoppel; and Chapter 10 ("Remedies") discusses potential remedies when there is a contract dispute.

6.8 Formalities Other Than Writing Requirements

Many jurisdictions have other contract formality requirements, in addition to writing requirements. These requirements may be designed to protect one or both parties to the contract, or even other parties. The requirements vary from one jurisdictions to the next, and we will not discuss them in great detail. But it is important to check the local law of the relevant jurisdiction to see if any of these special requirements apply.

Some other formality requirements relate to whether contracts are enforceable. For example, some jurisdictions may require that certain types of contracts be registered with or notarized by a certain authority, or that they be made under seal, in order to be valid and enforceable. In addition, statutes in some jurisdictions say that, in certain special situations where one party may have much more bargaining power than the other party, the stronger party to the contract must put certain kinds of provisions in very visible print, or those provisions will not be enforceable. The purpose of these statutes is generally to protect consumers. For example, these kinds of statutes might regulate certain types of clauses in standard insurance contracts, such as exclusion clauses--clauses that say the insurance policy does not cover a certain type of risk. Terms in these kinds of contracts may also in certain cases be unenforceable because the contracts are adhesion contracts, which were introduced in Chapter 1 ("Basic Aspects of Contract Law"), and will be further discussed in later Chapters. Contracts generally do not require witnesses to be enforceable, though witnesses may be useful in helping parties prove aspects of a transaction in court if there is later a dispute.

Other formality requirements may not actually relate to whether a contract is enforceable, but to some aspect of the performance of the contract. Two of the most common of these requirements are that the deed recording the transfer of title to real property (full legal ownership) must be delivered to the person receiving the property and registered with some competent authority in order to be effective. This does not mean that these formalities are required for a land sale contract to be valid. The deed is different from the contract. These requirements simply mean that, even if the contract is valid, the buyer cannot get full legal title to the property until these other formality requirements are met. The basic purpose of the recording requirement is to provide an accurate public record of who owns land.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 (“Other Contract Formation Problems”), Section 7.7b discusses adhesion contracts and unconscionability; and Chapter 8 ("Interpretation of Contracts"), Section 8.3i discusses how courts may not enforce certain terms in adhesion contracts.

6.9 Formality in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of current Cambodian law and the civil law tradition appear to be generally compatible with the approach to formality discussed in this Chapter. Although there are some differences, they do not seem to be particularly important.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) and other Cambodian laws contain many provisions relevant to the discussion of formality in this Chapter. These provisions seem basically compatible with the approach discussed in this Chapter, except perhaps that Cambodian law does not appear to have writing requirements for marriage contracts or those that cannot be performed within one year. Some of the relevant provisions are discussed below.

Basic Provisions

Decree #38D imposes a number of formality requirements on contracts. Most of these are writing requirements. Many of these requirements are similar to or the same as those found in other free market jurisdictions.

Article 4 provides that contracts "may be made orally or in writing," and that the law will set up "precise formalities" for making contracts. These provisions are consistent with the approach discussed in this Chapter.

Article 4 also states that "every contract not consistent with the formalities fixed by law shall be deemed void, except where there is any provision or rule of law contrary to this." This provision is consistent with statutes in some free market jurisdictions. However, as discussed above in Section 6.6, such contracts are not always void in many free market jurisdictions, since courts in those jurisdictions will enforce them in some circumstances. It is not clear if this is also true under Decree #38D. Article 4 does contain an exception for "provisions" and "rules of law" contrary to the rule that says such agreements are void. It is possible that this exception would allow courts to enforce agreements that did not meet formality requirements in some situations.

In addition, Article 1 provides that a contract is an agreement to "create, change, or terminate" obligations. This appears to mean that modifications of contracts are considered to be new contracts. That would also seem to mean that such modifications are still subject to writing requirements, as in the approach discussed earlier in this Chapter.

Specific Formality Requirements

As in other free market jurisdictions, specific kinds of contracts must meet certain formality requirements in order to be enforceable under Cambodian law.

Agreements That Must Be Written

The following are types of agreements that Decree #38D requires to be in writing to be enforceable:

(1) contracts regarding money or "items" worth more than 5,000 riels (Article 4);

(2) agreements to withdraw existing lawsuits to avoid contracts on the basis of incapacity, mistake, duress, or fraud (Article 20);

(3) contracts for loans with interest (Article 57);

(4) personal property mortgage contracts (Article 65);

(5) contracts for lease of real or personal property longer than one year (Article 101); and

(6) suretyship contracts (Article 112).

In addition, the current Land Law of Cambodia (Decree #100D (1992)) requires that the following type of agreement be written to be enforceable:

(7) contracts for the transfer of real property rights (estates) (Articles 179, 190, and 194).

And the current Cambodian Labor Law (1997) appears to require that the following types of agreements be written to be enforceable:

(8) apprenticeship contracts (Articles 52-53); and

(9) collective bargaining agreements (Article 96).

These requirements seem generally consistent with those discussed in this Chapter, except that there do not appear to be any writing requirements for marriage contracts or contracts that cannot be performed within one year. In addition, it appears that the "items" Article 4 describes may include not only goods, but other things as well. Finally, it is not clear exactly which real property rights require writings under Articles 179, 190, and 194 of the Land Law. However, "estate" is defined in great detail in Articles 6-9, and Article 10 lists nine possible estates, including "proprietorship," temporary possession, easements and mortgages. It may be that these are the estates subject to the writing requirement.

What the Writing Must Contain

Although there do not appear to be any general requirements in Decree #38D as to what a writing must contain in order to be sufficient, there are such requirements as to three specific kinds of contracts.

(1) Contracts dealing with items used in commercial trade must clearly and separately describe the items according to their quality and quantity. (Article 17)

(2) Contracts for loans with interest must clearly state the names of the parties, residences of the parties, loan amount, amount of interest, loan duration, and due date for repayment. In addition, the borrower must sign the contract. (Article 57)

(3) Personal property mortgage contracts must clearly specify the mortgaged property and the amount of debt. (Article 65)

These requirements seem consistent with the rules discussed in this Chapter.

Other Specific Formalities

There are a number of other formality requirements in various Cambodian laws related to contracts. In particular, Decree #38D and Decree #100D contain the following additional requirements.

(1) Sale deeds evidencing real property transfers must be "certified and registered" in order for the transfer to be valid, and such transfers are valid against third parties at the time of the certification and registration. Personal property transfers are valid against third parties when the property is "delivered into the hands of the purchaser," unless the transfer is done by certified deed, in which case it is valid against third parties at the time the deed is certified. (Article 41 of Decree #38D and Article 179 of Decree #100D)

(2) Personal property mortgage contracts are "considered valid" only when the creditor is in possession of the mortgaged property. (Article 65 of Decree #38D)

These requirements seem basically compatible with the rules discussed in this Chapter.

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to formality appears to be generally compatible with the one discussed in this Chapter, although the specific rules and specific kinds of contracts that must be written naturally differ to some extent in different jurisdictions. As always, it is important to check the relevant local law.

In France, certain important contracts must be written to be enforceable. For example, it appears that contracts for "any thing" over 5,000 francs must generally be evidenced by a signed writing or a "notarial act" in order to be valid. However, there seem to be a number of situations that are not covered by this rule, including "commercial contracts," or where it is "materially or morally impossible" to meet the requirement. For example, it may be "morally" impossible to use a writing for contracts within a family.

Or it might be impossible as a practical matter to use writings where they are not customary, such as at some markets. In addition, French law appears to require that real property insurance contracts, apprenticeship contracts, and residential lease contracts be written to be valid.

In France, when agreements fail to meet writing requirements, it appears that they may be either void or voidable. When agreements in the "public interest" fail to meet writing requirements, they are void and they cannot be enforced. "Public interest" agreements appear to be those that affect the public welfare, such as agreements to provide utilities, health care, or public transportation. When all other agreements fail to meet writing requirements, they seem to be voidable by either party.

6.10 Questions for Review

CHAPTER 6 -- QUESTIONS FOR REVIEW

1. Are oral contracts generally enforceable?

2. Why are some contracts required to meet writing requirements?

3. List five important types of contracts that some jurisdictions generally require to be written in order to be enforceable.

4. What are three general situations where courts in many jurisdictions will enforce agreements even though they fail to meet writing requirements?

5. Describe the basic rules about when agreements for the sale of interests in land must be written.

6. Describe the basic rules about when agreements that cannot be performed within one year must be written.

7. Describe the basic rules about when suretyship agreements must be written.

8. Describe the basic rules about when marriage agreements must be written.

9. Describe the basic rules about when sale of goods agreements must be written.

10. Give examples of some other types of agreements that some jurisdictions require to be written.

11. Are contract modifications subject to the same writing requirements as the original contracts were?

12. What does the law generally require for a sufficient writing?

13. What simpler requirements do some jurisdictions have for sufficient writings of sale of goods agreements?

14. What are the effects of failure to meet a writing requirement?

15. Give examples of some formality requirements other than writing requirements.

16. Is the Cambodian approach to formality generally compatible with the one discussed in this Chapter?

17. Is the civil law approach to formality generally compatible with the one discussed in this Chapter?

CHAPTER SEVEN

OTHER CONTRACT FORMATION PROBLEMS

7.1 Introduction

Chapters 2-6 of this text explained five basic elements that many jurisdictions require in order for a valid contract to exist. Those elements are real agreement (offer and acceptance); consideration (in common law jurisdictions); capacity; legality; and formality. These may be the most basic and common formation problems that affect whether an agreement is enforceable.

However, even if an agreement meets these basic requirements, other formation problems may affect whether it can be enforced. Some agreements with these types of problems may be called "defective" agreements. The "defects" in such agreements generally relate to how or why the agreements are formed. Specifically, the other formation problems discussed in this Chapter relate to:

(1) mistake;

(2) misrepresentation;

(3) duress;

(4) undue influence;

(5) unconscionability; and

(6) promissory estoppel.

The problems will be briefly summarized in Section 7.2 below, then discussed separately in the Sections that follow.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4f contains a more concise discussion of the other contract formation problems discussed in this Chapter; and Chapters 2-6 discuss basic formation problems that may affect whether an agreement is enforceable.

7.2 A Variety of Other Formation Problems May Affect Whether Agreements Are Enforceable

An agreement may meet the basic requirements for a valid contract, and seem to be enforceable by all parties. But in certain situations, such an agreement may still be "defective" for some other reason, and therefore may be void or voidable. And in some limited situations--where promissory estoppel applies--courts may even enforce promises where there is no enforceable agreement at all!

As noted above, this Chapter will examine six other formation problems that can affect whether a court will enforce agreements. These problems are briefly summarized below.

(1) Mistake -- Agreements which result from mistakes about existing facts may be void or voidable. Mistakes are beliefs that are not in accord with the facts. They may be bilateral (made by both parties) or unilateral (made by only one party). Basically, agreements resulting from mistake are void where the mistake is so serious there really is no "agreement" courts can fairly enforce, such as where the subject matter of the agreement has actually been destroyed at the time of the agreement. Agreements resulting from bilateral mistakes are voidable where the mistake is basic and about a material fact, and the party seeking to avoid the agreement did not assume the risk of the mistake. Agreements resulting from unilateral mistakes are voidable under the same rules, except that there is an additional requirement: either the other party caused or had reason to know of the mistake, or enforcement would be unconscionable. Examples might be where one party made a serious mistake as to the identity of the other party, or as to computation of prices in the agreement, assuming all the above requirements for mistake are met. Mistake is discussed in Section 7.3 below.

(2) Misrepresentation -- Agreements that are the result of misrepresentation are generally voidable, but they may be void. Misrepresentations are statements that are not in accord with the facts. They may be fraudulent (intentional) or innocent (unintentional). Basically, agreements that result from misrepresentation about the formation of an agreement--such as where a party did not even know he was signing a contract--are void. Agreements that result from misrepresentation in the inducement of the agreement are voidable where one party misrepresents a material fact and the other party justifiably relies on it in making the agreement. A potential example would be a seller misstating the nature or condition of goods to a buyer. This is discussed in Section 7.4.

(3) Duress -- Agreements resulting from duress are voidable. Duress is using an improper threat to induce a party to make a contract. Duress generally consists of threats to commit crimes or torts that will harm the victim, his family, or his property. This will be discussed in Section 7.5.

(4) Undue Influence -- Agreements resulting from undue influence are voidable. Undue influence is improperly influencing a victim to make an unfair contract, often through a relationship of trust or confidence. This will be discussed in Section 7.6.

(5) Unconscionability -- In very limited situations, courts may refuse to enforce agreements or parts of agreements because they are unconscionable. Unconscionable agreements are basically those whose process of formation or actual terms are so unfair that they shock the conscience of the court. This is more likely to occur with adhesion contracts. It is also more likely to occur where there are elements of both procedural unconscionability (extreme unfairness in the process of formation) and substantive unconscionability (extreme unfairness in the actual terms). Courts usually say unconscionable agreements are unenforceable, though it may be possible to sever or reform the unconscionable part of the agreement and enforce what remains. This will be discussed in Section 7.7.

(6) Promissory Estoppel -- Under the limited common law doctrine of promissory estoppel (detrimental reliance), courts may enforce a promise where one party justifiably relied on it and injustice would result if it is not enforced, even though there is no enforceable agreement. The formation "problem" here is really this potential injustice. Promissory estoppel is rarely used, because it requires: a real case; a promise by one party; actual reliance by another party; justifiable reliance by that same party; and an unjust loss by the party who relied if the promise is not enforced. The last two elements are not usually present. Where courts do use the doctrine, the promise is enforceable to the extent justice requires--not necessarily to the same extent as a normal contract promise. Reliance damages seem most common where promissory estoppel applies. This is explained in Section 7.8.

Basically, agreements made under the influence of one of the first four types of events described above--mistake, misrepresentation, duress, or undue influence--may be unenforceable because they are not knowing and voluntary agreements, even though they may have an offer and an acceptance. In these four situations, parties have been forced or pressured to agree, have been tricked into agreeing, or have simply made an important mistake about the agreement.

The last two events described above--unconscionability and promissory estoppel--reflect special rules courts use in very limited situations to achieve justice where other rules will not. Unconscionable agreements are not enforceable because of some great unfairness in how the agreement was formed or its actual terms. And courts use promissory estoppel only where--even though no enforceable contract exists--one party has justifiably relied on a promise, and injustice will result if the promise is not enforced.

One other type of contract formation problem which is not discussed in detail in this Chapter is the situation where quasi-contract applies.

Under quasi-contract, courts may actually impose contract obligations--even though they cannot enforce a contract--in order to avoid unjust enrichment of one of the parties. This text will not discuss this situation in detail here because it was explained in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5. But like promissory estoppel, quasi-contract is a doctrine courts use to try to prevent injustice even though no contract can be enforced by the party seeking to do so.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains a more complete discussion of quasi-contract; and Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e discusses promissory estoppel.

7.3 Agreements Resulting from a Mistake about a Material Fact May Be Void or Voidable

Sometimes parties make mistakes about their agreements at the time the agreement is formed. For example, a party who is selling various goods may add the prices incorrectly. Or a party buying something may make a mistake about how much the item is worth.

*** **DEFINITION:** A **mistake** is a belief that is not in accord with the facts.

Agreements may be invalid because of mistakes. The reason such agreements are sometimes invalid appears to be that the law feels that, when certain mistakes occur in the formation of an agreement, there has not really been a knowing agreement that can fairly be enforced. However, only certain kinds of mistakes provide a basis for parties to avoid agreements. Parties cannot avoid agreements simply because they were careless in making them!

Whether an agreement resulting from a mistake is valid depends in part on whether the mistake is made by both parties to the agreement (a "bilateral" mistake), or by only one party to the agreement (a "unilateral" mistake). The rules in this area were summarized very briefly in Section 7.2 above.

Basically, some bilateral and unilateral mistakes are so serious that no agreement at all can be formed when they occur. In these situations, courts feel that there is no "agreement" that they can fairly enforce. Any apparent agreement is void.

When mistakes in the formation of agreements are not this serious, the agreements may still be voidable if certain requirements are met. Basically, agreements resulting from bilateral mistakes are voidable where the mistake is basic and about a material fact, and the party seeking to avoid the agreement did not assume the risk of the mistake. Agreements resulting from unilateral mistakes are voidable under the same rules, except there is an additional requirement: either the other party caused or had reason to know

of the mistake, or enforcement would be unconscionable. Because of the extra requirement for unilateral mistakes, it is more difficult for a party to avoid an agreement on that basis. Obviously, the rules on this subject are complex. So it is important to read carefully Sections 7.3a and 7.3b below, where the rules are discussed specifically.

Before considering the kinds of mistakes that may cause an agreement to be invalid, it is important to understand exactly what is--and what is not--a "mistake of fact." A mistake of fact is a wrong belief about an existing fact. A "fact" is something that is true about the present or the past. For example, if Much agrees to move a pile of rocks, believing that the rocks weigh 500 kilos, but in fact the rocks weigh 1,000 kilos, Much has made a mistake of fact.

However, a mistake of fact is different from a mistaken opinion or prediction about the future. For example, if Borin makes an agreement with someone because he has the mistaken opinion that the other party is trustworthy, that is not a mistake of fact, and Borin cannot avoid the agreement on that basis. Or if Sokry agrees to buy some rice because he mistakenly thinks that the price of rice will rise in the future, and that he can sell the rice later at a good profit, that is not a mistake of fact, and Sokry cannot avoid the agreement on that basis.

Finally, it is important to stress again that only some mistakes affect whether an agreement is enforceable. As noted above, specific requirements must be met in order for agreements to be void or voidable because of mistakes. This is because, in general, courts are reluctant to refuse to enforce agreements on the basis of mistakes--especially unilateral mistakes.

*** ***WHY IS THIS IMPORTANT?*** Why are courts in free market jurisdictions generally reluctant to refuse to enforce agreements on the basis of mistake?

The law wishes to encourage parties to be careful and not make important mistakes about their contracts. In fact, courts will not save parties from the consequences of all mistakes. This is because the law wants the knowledge and diligence of the parties--not the courts--to be the main protection against losses due to mistakes. In this way, parties are forced to be careful, and the economic system can regulate itself, at least to some extent.

This is especially true in the case of unilateral mistakes. If courts could refuse to enforce an agreement every time a party made such a mistake, every party who made an agreement that turned out to be difficult or less profitable than he wished could try to avoid the agreement, claiming he had simply made a mistake! Then no one could rely on his agreements. And courts could not protect the reasonable expectations of the parties, which is an important goal of contract law. This could have a bad effect on development, the efficient operation of the economy, and the rule of law.

7.3a Bilateral Mistakes Occur Where Both Parties to an Agreement Are Mistaken about the Same Fact

A bilateral mistake, or "mutual mistake," occurs when both parties to an agreement are mistaken about the same fact. For instance, Thanna may agree to buy Chuon's moto for $1,000, and both parties may think that is a fair price. But if neither party knows that the moto is actually worth only $500 because of a recent change in the market, then there is a bilateral mistake. That is because both parties made a mistake about the value of the moto. Of course, not all mistakes affect the validity of agreements. In fact, the type of mistake Thanna and Chuon made probably does not affect the validity of their agreement, as will be explained later in this Section.

(1) An Agreement Resulting from a Bilateral Mistake Is Void If Both Parties Make a Mistake So Serious That There Really Is No "Agreement" Courts Can Fairly Enforce

Some bilateral mistakes are so serious that there really is no agreement courts can fairly enforce between the parties, and any apparent agreement is void. Such mistakes occur rarely. And this is a very difficult area, because while certain kinds of mistakes are serious enough that the agreement is void, there does not appear to be any clear general definition of when that happens!

In any case, it appears that such mistakes occur only when the parties have a fundamental misunderstanding about the most important terms of their apparent agreement. Two important examples of this are: (1) mistakes about the existence of the particular subject matter of the agreement; and (2) mistakes about the meaning of material terms, such as the identity of the subject matter. These are discussed below.

(1) Mistakes about the Existence of the Particular Subject Matter -- Sometimes both parties to an apparent agreement make a mistake about whether the particular subject matter of their agreement exists. Usually this problem occurs when, at the time of the agreement, the subject matter of the agreement has already been destroyed by natural or human forces, such as an earthquake or a war, but the parties do not know about it. This kind of agreement is void, because such a mistake is very serious. If the subject matter existed at the time of the offer but is destroyed before the attempted acceptance, many jurisdictions say the offer terminates at the time the subject matter is destroyed. This was already discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6d. In any event, no valid agreement can occur where the specific subject matter does not exist at the time the offeree attempts to accept the offer.

******* ***CASE STUDY 153***

FACTS The Blue Sea Shipping Company wants to buy a big new ship to add to its fleet of cargo ships. It decides to negotiate with a ship owner named

Peou to buy a ship called the Eternal. The parties are close to reaching an agreement.

However, only one hour before the parties reach an agreement for the sale of the Eternal, the ship sinks in a bad storm in the Gulf of Thailand and is completely destroyed. Neither the Blue Sea Company nor Peou finds out about the sinking until after the agreement is signed. When Peou finds out, he tells Blue Sea he is sorry, but he cannot honor the agreement. Blue Sea says it will ask the court to order Peou to honor the agreement or pay damages.

QUESTION OF LAW Can Blue Sea enforce this agreement?

DECISION No. This agreement is void because both parties made a mistake about the existence of the specific subject matter of the agreement (the ship Eternal).

Agreements are void when the parties both make a mistake about whether the particular subject matter of the agreement exists, because this kind of mistake is so serious that the parties really have no "agreement" the courts can fairly enforce. In this case, both the Blue Sea Company and Peou thought that the ship Eternal existed at the time they made the agreement for the sale of the ship. However, in fact, the ship had sunk and been completely destroyed just before the parties made the agreement! Because of this bilateral mistake, the agreement for the sale of the ship is void. So the Blue Sea Company cannot enforce it.

Of course, this rule applies only where the parties are negotiating about a specific subject matter. For example, suppose two parties simply agree that one party will buy "a healthy one year old cow" from the other party, and the cow that the seller is thinking about selling is actually dead. That is still an enforceable agreement. In that case, the seller must find another cow in order to obey the agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6d discusses the rule in many jurisdictions that destruction of the particular subject matter of an offer before acceptance terminates the offer.

(2) Mistakes about the Meaning of Material Terms -- Sometimes both parties make such a serious mistake about the meaning of a material term in the agreement, such as the identity of the subject matter, that the court cannot fairly enforce the agreement. So it is void. This basically occurs where a



material term in the parties' agreement is ambiguous--it may mean more than one thing. In this situation, many jurisdictions say the agreement is void if:

(a) the parties have fundamentally different understandings of the meaning of the term; and

(b) neither party knows or has any reason to know of the different understanding of the other party.

This situation occurs rarely, because the parties to such agreements usually have some reason to know about the mistake.

*** ***CASE STUDY 154***

FACTS Suppose that the story in Case Study 153 happens in a somewhat different way. Suppose that the Blue Sea Company signs the same agreement with Peou about the sale of a ship called Eternal, but that the ship has not sunk.

However, it turns out Peou actually owns two cargo ships called Eternal--one docked in Thailand and one in Vietnam--and the parties to the agreement each intended a different ship! The ships are fairly similar, and neither party has any reason to know the other party intended a different ship. When Blue Sea learns of this, it says Peou must sell it the ship in Thailand, since that is what it intended to buy. But Peou refuses, saying he meant the ship in Vietnam, so that is what the agreement meant.

QUESTION OF LAW Can either party enforce this apparent agreement?

DECISION No. This apparent agreement is void because the parties had fundamentally different understandings of the term "Eternal"--the subject matter of the agreement--and neither party knew or had reason to know of the different understanding of the other party.

Where a material term in the parties' agreement is ambiguous, and neither party knows or has reason to know of the different understanding of the other party, then the agreement is void. In this case, Blue Sea and Peou made an agreement about the sale of a ship called "Eternal." However, it turned out that Peou owned two ships called "Eternal," and the parties had different ideas about which ship the agreement described. In addition, neither party knew or had a reason to know that the other party had a different understanding. In this situation, the mistake is so serious that a court cannot fairly enforce the agreement. Therefore, the agreement is void, and Peou cannot enforce it.

Although mistakes like the one in Case Study 154 are possible, it is much more common for parties to have different understandings of what a contract term means that are not so serious that they prevent the formation of the contract. In that situation, the contract may be voidable, and the party

hurt by the mistake may still try to avoid it, as discussed in the remainder of Section 7.3a below.

Or it may be that neither party wishes to avoid the contract, but that the parties simply have a dispute about whose understanding is correct. Courts try to resolve such disputes and enforce the contract. However, if the parties disagree about what a material term means and a court cannot interpret the term, even using all the available rules of interpretation, then the agreement probably cannot be enforced. This is basically the same situation as described in Case Study 154--a court simply cannot determine what a material term in an agreement meant, so it cannot enforce the agreement. This will be discussed in detail in Chapter 8 ("Interpretation of Contracts"), Section 8.5.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts") discusses rules courts use to help them interpret contracts; Section 8.5 discusses what courts do when they cannot interpret a material term in an agreement.

(2) An Agreement Resulting from a Bilateral Mistake Is Voidable by the Party Hurt by the Mistake If the Mistake Is Basic and Material, and the Party Seeking to Avoid the Agreement Has Not Assumed the Risk of That Mistake

As noted above, sometimes both parties make a mistake about the agreement that is not so serious that it prevents any agreement from being formed. In this situation, the contract may be voidable.

However, parties can avoid such agreements only if certain requirements are met. For example, many jurisdictions in the United States say that the party hurt by such a mistake may avoid the agreement if:

(1) the mistake is about a basic assumption of the agreement;

(2) the mistake has a material effect on the bargain;

AND (3) the party trying to avoid has not assumed the risk of the mistake.

Some of these phrases are not easy to define. A "basic assumption" is something that affects what each party expects to gain from the bargain. For example, in an agreement to buy a car, one basic assumption would probably be that the car has an engine. In addition, as will be discussed below, a mistake as to the quality or value of the subject matter may also be a mistake as to a basic assumption.

A "material effect" is basically one that creates such an imbalance in the exchange of contract performances that one party benefits much more than he expected, and the other party loses much more than expected. The result is that it might be unfair to require the "losing" party to perform the agreement.

For example, two parties may agree about the sale of a car without knowing the car lacks an engine, perhaps because the engine has just been stolen. In that situation, the seller would probably receive a big benefit, and the buyer would probably suffer a big loss, since the price the parties negotiated would likely be for a car with an engine.

A party "assumes the risk" of a mistake when he agrees that if that kind of mistake occurs, then it will be his responsibility, and not the responsibility of the other party. This may occur expressly or impliedly.

The parties might expressly agree about who assumes certain risks. For example, an agreement for the sale of land might state that the seller will not be responsible for any problems related to the title to the land (ownership) that he possesses. In that situation, if there is a problem with the true title to the land, it is the responsibility of the buyer.

In other situations, a party may know that he does not have complete knowledge about the agreement and that he could be making a mistake, but the party may make the agreement anyway. If this occurs, many jurisdictions say that the party who "knows he does not know" has assumed the risk of a mistake, and that he cannot avoid the agreement on that basis. For example, if a buyer of a jewel knows that the jewel might be a fake, then he has probably assumed the risk that it will turn out to be fake. This rule is very important, since many types of agreements are made this way.

In still other situations, courts may simply place the risk of a particular mistake where it is reasonable to do so. This depends on the specific facts of the case. For example, many courts say that where a party agrees to sell land, the seller assumes the risk that the land may have valuable minerals underneath it--and so may be far more valuable than the seller thought--because otherwise the "finality" of land transactions would be harmed. Many courts also say that, when a party agrees to build a building on land owned by another party, the builder is taking the risk that the construction job may be more expensive than the parties thought. That might occur because the soil is very rocky or there is some other problem. The reason for this rule is that the law assumes the builder will have more expertise in judging soil conditions than the land owner.

It is important to remember that, in jurisdictions that apply these rules, all three of the elements above must exist for a party to avoid an agreement because of a bilateral mistake. If one element is missing, then the party who is hurt by the mistake cannot avoid the agreement.

Two important kinds of bilateral mistake which may cause parties to try to avoid agreements occur where both parties are wrong about:

(1) the value of the subject matter of an agreement; or

(2) the quality of the subject matter of an agreement.

Of course, these types of mistake are related. Cases that involve mistakes about value or quality can be very hard to decide. They will be discussed briefly below.

In general, unless the agreement says otherwise or there are special circumstances, each party assumes the risk that he will be wrong about an item's value. So generally neither party can avoid the agreement on that basis. For example, suppose a party pays a price higher than the market value for a new pair of shoes at the market because the party is not familiar with how much such shoes usually cost. That party cannot avoid the agreement on the basis of bilateral (or unilateral) mistake. This is because courts say that parties generally assume the risk that they will be wrong about the value of things they buy or sell. Value can be very subjective, and it may be that everyone should "know he does not know" about it. It might also be argued that beliefs about value are really opinions, so they should not be considered "mistakes of fact."

However, sometimes a party can avoid an agreement where both parties are wrong about the quality of the subject matter, based on the rules discussed above. That is, occasionally parties do not assume the risk that they will be wrong about the quality--the physical nature--of an item. This is possible where both parties are sure in their belief about some basic quality of the subject matter of the agreement, but they both turn out to be wrong.

For example, both parties may be sure about whether a particular car has an engine, or whether a certain brand of car has a certain feature, but they may turn out to be wrong. Of course, such mistakes about quality also affect the value of the subject matter. But the basic problem is the mistake about quality. In other words, the problem is not that the parties are mistaken as to the general value of cars like the one they are discussing. It is that they are mistaken about the quality or physical reality of the car.

Compare the two Case Studies below.

*** ***CASE STUDY 155***

FACTS Thy and Vey were negotiating the sale of a small stone which Thy owned. Both parties believed that the stone was probably a topaz, but neither party was sure. Vey agreed to buy the stone for $5, and the parties exchanged the money for the stone.

However, the next day, Vey showed the stone to his friend Sary, who was an expert on jewels. Sary told Vey that the stone was actually an uncut diamond worth $4,000! When Thy heard about this, he tried to rescind the agreement and get the stone back from Vey.

QUESTION OF LAW Can Thy rescind this agreement and get the stone back?

DECISION No. Thy cannot rescind the agreement because he assumed the risk of a mistake like this.

When parties both make a mistake about an agreement, the party hurt by the mistake may avoid the agreement if the mistake was about a basic assumption of the agreement; the mistake has a material effect on the agreement; and that party did not assume the risk of the mistake.

In this case, Thy and Vey made a big mistake about the physical quality of a stone Vey agreed to buy from Thy. In fact, the stone the parties thought was a topaz turned out to be a valuable diamond! This was a mistake about a fundamental assumption. And it had a material effect on the agreement, since the difference between the values of the two different kinds of stones is very large. However, Thy assumed the risk of this mistake, because he "knew he did not know" whether the stone was really a topaz or not. Despite this, Thy made the agreement. In that situation, Thy has assumed the risk that the stone would turn out to have a different (and more valuable) physical nature--just as Vey assumed the risk that it would turn out to have a different (and less valuable) physical nature! So Thy cannot rescind the contract.

*** ***CASE STUDY 156***

FACTS A farmer named Chandara wanted to buy a cow. His neighbor Sopeng offered to sell him a particular cow, which both parties believed was unable to bear young. The parties agreed to the sale of the cow at a certain price.

However, just before Sopeng was to deliver the cow to Chandara, Sopeng discovered that the cow was pregnant! He told Chandara that he would not deliver the cow, because he would have charged much more money if he had known the cow was fertile. Chandara asks the court to enforce the contract.

QUESTION OF LAW Can Sopeng avoid this agreement because of the parties' mistake about the cow?

DECISION Yes. Sopeng can avoid this agreement because the mistake about the cow meets all the requirements for parties to avoid such agreements.

When parties both make a mistake about an agreement, the party hurt by the mistake may avoid the agreement if the mistake was about a basic assumption of the agreement; the mistake has a material effect on the agreement; and that party did not assume the risk of the mistake.

In this case, both Chandara and Sopeng mistakenly thought the cow Chandara was buying from Sopeng was unable to bear young. This mistake about the quality or physical nature of the cow obviously was a mistake about a basic assumption. And it had a material effect on the agreement, since the prices for fertile cows are far higher than those for infertile cows.

The difficult question is whether Sopeng assumed the risk that the cow was fertile. Many courts would say that Sopeng did not assume this risk in this situation. This is because both parties were very confident that the cow was infertile--that it had a certain quality or physical nature. Because both were sure about this, many courts would say Sopeng did not assume this particular risk, and so he can avoid the agreement.

Of course, Sopeng did assume the risk that he was charging too low a price for an infertile cow. That is, he assumed the risk that he was making a mistake purely as to the value of the cow. Suppose it had turned out that the cow was infertile--as the parties thought--but that Sopeng had still made a big mistake about the price, because he did not know much about the market for cows. In that case, Sopeng could not avoid the agreement.

In addition, if a seller has made promises about the quality of the items being sold--which is called providing a warranty--then the buyer may still have a claim against the seller for breach of warranty, if the items turn out to be of lower quality than the warranty says. For example, suppose a seller warrants that the diamond he is selling for $100 is real. But it turns out to be a fake worth only $2. In that situation, the buyer may have a claim for damages against the seller for breach of warranty. Such promises might also be misrepresentations which could result in a voidable agreement, as will be discussed in Section 7.4, below.

7.3b Unilateral Mistakes Occur Where Only One of the Parties to an Agreement Is Mistaken about a Fact

A unilateral mistake occurs when only one of the parties to an agreement is mistaken about a fact. For example, suppose Heang agreed to buy Bunny's pig, and Heang thought the pig was male. But Bunny knew it was female. In that case, a unilateral mistake occurred, because only one party--Heang--was mistaken about the gender of the pig. This kind of mistake is probably more common than bilateral mistake.

Most unilateral mistakes do not affect the validity of agreements. That is, a contract is usually binding on the parties despite the fact that one of the parties made a mistake. The reason for this is that, as discussed above in Section 7.2, contract law is designed to protect the reasonable expectations of the parties to a bargain. But courts cannot protect these expectations if parties who are unhappy with their bargain can avoid the contract simply by claiming to have been "mistaken" about something when they made the contract! However, in certain special situations, even unilateral mistakes may result in void or voidable agreements.

(1) An Agreement Resulting from a Unilateral Mistake Is Void If One Party Makes a Mistake So Serious That There Really Is No "Agreement" Courts Can Fairly Enforce

Some unilateral mistakes are so serious that there really is no "agreement" between the parties that courts can fairly enforce, and any apparent agreement is void. This occurs even more rarely than with bilateral mistakes. The main example of this kind of mistake occurs where the offeror makes a mistake in transmitting his offer to the offeree, and an unintended party tries to accept the offer. As discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.8a and Case Study 69--about the mistake the Tith Textile Company made in offering to sell silk to its best customer--the unintended party can accept the offer and form a contract only if he does not know and has no reason to know about the mistake of the offeror. But when the unintended party knows or has reason to know of the mistake, then no contract is formed between the parties. The reason for this rule is that the law generally protects the rights of offerors to make contracts only with the parties they wish.

******* ***CASE STUDY 157***

FACTS Sotheavy writes an offer to sell her television to Buntheth, an old friend and someone to whom she has sold items in the past. In Sotheavy's offer, she talks about her past dealings with Buntheth, as well as their friendship.

However, by mistake, Sotheavy sends the offer to the wrong address, where it is received by a different person--also named Buntheth! This different Buntheth tries to accept Sotheavy's offer. When Sotheavy refuses to honor the "agreement," the different Buntheth asks the court to enforce it.

QUESTION OF LAW Can the unintended Buntheth enforce an agreement against Sotheavy?

DECISION No. There is no contract here because the unintended Buntheth was not the intended offeree, and he had good reason to know that Sotheavy had made a mistake.

When an offeror makes a mistake in transmitting an offer and a party who is not the intended offeree tries to accept it, the apparent agreement is void if the party trying to accept knew or had reason to know about the mistake. In this case, Sotheavy mistakenly sent her offer to sell a television to the wrong Buntheth. But in her offer, she talked about her friendship with the right Buntheth, and about her prior dealings with the right Buntheth. These statements gave the wrong Buntheth reason to know that Sotheavy had made a mistake, and that the wrong Buntheth was not the intended offeree. So the wrong Buntheth could not accept the offer, and no contract was formed. In this case, there is nothing for the wrong Buntheth to enforce.

******* ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.8 contains further discussion of the general rule about who can properly accept an offer and the exceptions to that rule.

(2) An Agreement Resulting from a Unilateral Mistake Is Voidable by the Mistaken Party under the Same Rules as a Bilateral Mistake, with an Added Requirement: the Other Party Caused or Had Reason to Know of the Mistake, or Enforcement Would Be Unconscionable

Sometimes one party makes a mistake about the agreement that is not so serious that it prevents an agreement from being formed. In this situation, many jurisdictions may still allow the party who made the mistake to avoid the agreement, but only if certain requirements are met. For example, many jurisdictions in the United States say that the agreement is voidable--if:

(1) the mistake is about a basic assumption of the agreement;

(2) the mistake has a material effect on the bargain;

(3) the party trying to avoid has not assumed the risk of the mistake;

AND (4) either (a) the other party caused the mistake or had reason to know about it;

or (b) enforcing the agreement would be unconscionable.

The first three of these requirements are basically the same as those discussed above with regard to bilateral mistakes. Of course, in this unilateral mistake situation, the "basic assumption" and "material effect" requirements apply to the unilaterally mistaken party. In other words, the mistake must be about a "basic assumption" of the mistaken party, and have a "material effect" on the bargain the mistaken party expected.

However, for unilateral mistakes, there is an extra requirement: a party can avoid an agreement based on his unilateral mistake only if he meets all the bilateral mistake requirements, and either the other party caused or had reason to know of the mistake, or enforcing the agreement would be unconscionable. For example, a sub-contractor bidding on a construction contract might forget to include the cost of steel in his bid to the general contractor. If that happened, it would probably meet the first three requirements above. But for the sub-contractor to avoid any possible agreement, he would also have to show that the general contractor caused or had reason to know of the mistake, or that enforcement against the sub-contractor would be extremely unfair to the sub-contractor.

The first way to meet this extra requirement is to show that the other party to the agreement caused or had reason to know about the mistake. In the example above, in order to meet the extra requirement this way, the sub-contractor would have to show that the general contractor caused or

had reason to know of the mistake about the steel. This might occur if the bid was obviously wrong because it was so different from other bids.

The second way to meet the extra requirement is to show that enforcing the agreement would be unconscionable. Unconscionable agreements are discussed in more detail in Section 7.7 of this Chapter. Basically they are agreements that are extremely unfair to one party because of the process of formation or the actual terms of the agreement. In the mistake situation, the mistaken party would have to show that enforcement of the agreement would be extremely unfair. It is usually very difficult to show this. In the contractor example above, the sub-contractor would have to show that enforcement would cause him extreme hardship, probably because of the actual terms of the agreement. This might occur if the mistake would cause him to make no profit on the contract, or even lose money.

However, in order for a party to show that enforcement would be unconscionable because of a unilateral mistake, some jurisdictions say the mistaken party must show not only the bad effects for himself, but also that the other party would not be harmed if the mistaken party was allowed to avoid the agreement. For example, suppose the general contractor in the above example had already relied on the sub-contractor's bid in submitting his own bid. In that case, the sub-contractor might not be allowed to avoid any agreement formed--even if the result was that the sub-contractor would make no profit, or even lose money! This is because the general contractor would be harmed if the sub-contractor were allowed to avoid any agreement. Of course, the sub-contractor would probably not be allowed to revoke his bid for a reasonable time if the general contractor could meet the requirements of promissory estoppel. This was discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, and will be discussed in more detail in Section 7.8 of this Chapter.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e contains further discussion of how promissory estoppel may prevent an offeror--especially a sub-contractor--from revoking a bid made to a general contractor.

This extra requirement for unilateral mistakes means that, as noted above, it is much more difficult to avoid an agreement based on a unilateral mistake. If this extra requirement is not met, the contract is probably valid. However, although it is difficult to meet all the requirements, there are still situations where parties may avoid agreements because of unilateral mistakes.

Four important situations where parties may try to avoid such agreements are where parties make unilateral mistakes:

(1) about the identity of the other party;

(2) about the nature of the subject matter of the contract;

(3) about the computation of prices; or

(4) because of a failure to read carefully the written agreement.

Each of these situations will be discussed below.

(1) The Identity of the Other Party -- Sometimes one party is mistaken about the true identity of the other party to an agreement. In other words, the first party intends to make a contract with the other party, but the first party is mistaken about who the other party really is. If this occurs, the four requirements above may be met, and the mistaken party may be able to avoid the agreement.

*** ***CASE STUDY 158***

FACTS Channo was negotiating an agreement to sell an expensive diamond ring to Run Munthit, believing that Run Munthit was a wealthy man who was very well known in the province. Run Munthit told Channo about how he was thinking of buying this kind of ring for all of his many female relatives. In addition, during the negotiations, Munthit drove away from Channo's shop in a new car and came back several times, saying he had to go think about the deal.

Finally, the parties agreed to the sale of the ring for $1,000. Channo gave Run Munthit the ring, and Run Munthit paid $100 as a down payment, promising to pay the rest the following month. Channo agreed, not wanting to lose the sale to such a wealthy man.

Later, Channo learned that the Run Munthit who bought the ring was actually a different man with the same name as the wealthy man, and that the Run Munthit who bought the ring was not wealthy. In fact, the Run Munthit who made the agreement about the ring had almost no money left after making the $100 down payment. And he had borrowed the new car from a friend of his, who was a taxi driver! Channo sought to avoid the contract and get his ring back.

QUESTION OF LAW Can Channo avoid this agreement?

DECISION Probably. Channo's mistake about Run Munthit's true identity probably meets the requirements for Channo to avoid the agreement based on unilateral mistake.

Where a party to an agreement makes a unilateral mistake, that party may avoid the agreement if the mistake was about a basic assumption of the agreement; the mistake has a material effect on the agreement; that party did not assume the risk of the mistake; and either the other party caused or had reason to know of the mistake, or enforcement would be unconscionable.

In this case, Channo agreed to sell Run Munthit an expensive ring because he believed Run Munthit was a wealthy man who could afford it. This case probably meets the first three requirements for Channo to avoid the agreement based on his unilateral mistake. That is because this mistake about Run Munthit's ability to pay for the ring was about a basic assumption, it will have a material effect on the agreement, and courts would probably say that sellers like Channo do not assume this kind of risk.

The fourth requirement also seems to be met here. It could be met in either of two ways. First, the less wealthy Run Munthit did have reason to know of Channo's mistake, since the wealthy Run Munthit was so well known. And the less wealthy Run Munthit may have actually caused the mistake, since it appears that he pretended to be wealthier than he was, by talking about giving expensive diamonds to many female relatives, and by driving around in his friend's new car. Even if a court did not think the requirement was met this way, it seems likely that enforcing the agreement would be unconscionable. This is because, even though the $1,000 price might be reasonable, there is a great risk that Channo will never be paid for the ring! And even if he can get the ring back, he may be required to spend a great deal of time and trouble to do so.

So in this case, Channo can probably rescind the contract and get the ring back. Of course, he could also wait to see if the less wealthy Run Munthit actually did breach the agreement and sue if that occurred. But this might delay Channo's recovery of the ring, and increase the risk that he would not get it back at all.

A similar situation which this text has already discussed occurs if a party who is not the intended offeree receives the offer. In that situation, if the party mistakenly receiving the offer had reason to know about the mistake, then no contract is formed--the agreement is void--because in general, only the intended offeree can accept an offer. This was discussed in Chapter 2, Section 2.8, and again in Section 7.3b above. By contrast, the rule discussed immediately above applies where the mistaken party <u>does</u> intend to make an agreement with the person who accepts--but the mistaken party has a wrong idea about who the offeree really is.

******* ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.8 contains further discussion about when a party may accept an offer even though that party is not the intended offeree.

(2) <u>The Nature of the Subject Matter</u> -- Sometimes one party to an agreement makes a mistake about the nature of the subject matter of the agreement. This kind of unilateral mistake may also meet the requirements for the mistaken party to avoid the agreement.

*** ***CASE STUDY 159***

FACTS Chheng was a government official who wished to buy dredging equipment to help improve the Kompong Som port, and increase the amount of shipping the port could handle. Chheng inspected a particular dredge owned by Nariddh, and finally agreed to buy it, for a fair price. As part of the agreement, Nariddh agreed to make certain repairs to the dredge.

However, after the dredge was delivered, Chheng found that the dredge could not perform the operations for which Chheng intended to use it. Nariddh was not aware of the operations Chheng wanted to perform with the dredge, and he did nothing to cause Chheng's mistaken belief about the dredge. Chheng seeks to avoid the contract.

QUESTION OF LAW Can Chheng avoid this agreement?

DECISION Probably not. It appears that Chheng cannot meet all the requirements to avoid this agreement based on unilateral mistake.

Where a party to an agreement makes a unilateral mistake, that party may avoid the agreement only if the party meets all four of the requirements described above. In this case, Chheng made an agreement to buy a dredge from Nariddh. But Chheng was mistaken about the work that the dredge could do. Chheng could probably meet the first two requirements, since this mistake was about a basic assumption and would probably have a material effect on his benefits under the agreement. Chheng might even be able to meet the third requirement, by showing that he had not assumed the risk of the mistake, although it seems likely that buyers usually do assume the risk of mistakes like this.

But it seems that Chheng could not meet the fourth requirement. Nariddh did not cause or have reason to know of Chheng's mistake. In addition, it seems unlikely that enforcement would be unconscionable here, because there was no unfairness in the way the contract was formed or in its terms, and Nariddh already relied on the agreement by repairing and delivering the dredge. Chheng will probably have to obey the agreement or provide a remedy.

(3) Computation of Prices -- One of the most common types of unilateral mistake occurs when a party makes a mistake in calculating the price of an offer. This occurs most often in bids for construction or other projects. Such mistakes may occur because of errors in arithmetic, because of errors in typing the offer, or because the bidder simply forgot to include something he should have, such as the figure for the cost of steel, or a sub-contractor's bid. If this kind of mistake does occur, courts apply the same requirements as for other unilateral mistakes.

It appears that courts generally say that parties do not assume the risk that they will make such mistakes. Perhaps courts believe such mistakes are often understandable, and that they should not always create binding contract obligations, which could cause great harm to the party who made the mistake. On the other hand, it is debatable how understandable such mistakes really are. It might appear that clerical and mathematical tasks are an important part of any business, and that parties in business should assume the risk that they will make errors in performing those tasks. It may be part of the normal business responsibilities of many parties not to make such errors.

In any event, compare the following two Case Studies.

*** ***CASE STUDY 160***

FACTS The Ministry of Education solicited bids for the construction of 10 new primary schools in Kompong Thom Province. One of the bidders was the Future Construction Company. Future submitted a bid to do all the work for $1,200,000. This was the lowest viable bid the Ministry received--by about $20,000--and the Ministry accepted Future's offer.

However, a few days later, Future realized that it had made a mistake in calculating the total bid amount. In fact, it had simply added some of the figures incorrectly, and the correct total should have been $1,225,000. Future asked the court to allow it to rescind the agreement.

QUESTION OF LAW Can Future rescind this agreement?

DECISION Probably not. Future probably cannot meet all the requirements for it to rescind the agreement based on its unilateral mistake.

Where a party to an agreement makes a unilateral mistake, that party may avoid the agreement only if the party meets all four of the requirements described above. In this case, Future made a mathematical error in calculating its total bid amount, which resulted in the Ministry receiving (and accepting) the bid at $1,200,000, instead of the $1,225,000 which Future would have bid if it had not made the mistake. The correctness of a total bid amount generally is a basic assumption, and many courts would say Future has not assumed the risk of this kind of mistake. But Future probably cannot show that its mistake would have a material effect on the agreement, since its error was only about 2% of the total amount of its bid. In addition, the Ministry did not cause the error, and did not have any reason to know about it, since Future's total bid was so close to the next lowest bid (only a $20,000 difference). And it is unlikely that a court would find enforcement to be unconscionable, since it is unlikely that Future will be severely harmed by such a relatively small error. So in this case, Future probably cannot meet all the requirements to avoid the contract based on unilateral mistake.

*** ***CASE STUDY 161***

FACTS Suppose that the story in Case Study 160 happened in a somewhat different way. Suppose that Future was bidding on the same construction project, but that it did not make the $25,000 mathematical error described above. In this new scenario, Future's bid on the project was only $1,100,000--$120,000 less than the next lowest bid! The Ministry quickly accepted Future's bid.

However, a few days later, Future discovered that it has forgotten to include in its bid the cost of a plumbing sub-contractor, who had made a bid to do all the plumbing work for $125,000. The correct total of its bid should have been $1,225,000. Future asked the court to allow it to rescind the agreement.

QUESTION OF LAW Can Future rescind this agreement?

DECISION Probably. Future can probably meet all of the requirements to avoid this agreement on the basis of unilateral mistake.

Where a party to an agreement makes a unilateral mistake, that party may avoid the agreement only if the party meets all four of the requirements described above. In this case, Future forgot to include the sub-contractor's bid for the plumbing work in its general bid. That resulted in a bid $125,000 lower than it would have been if Future had not made the mistake. This is clearly a mistake about a fundamental assumption (the bid price); it has a material effect on the deal (a difference of over 10% of the total bid amount); and Future has not assumed the risk of this mistake. In addition, the Ministry had reason to know of the mistake, because the bid was $120,000 lower than the next lowest bid. And enforcement in this situation would probably be unconscionable. This is because it would probably destroy most or all of Future's profit, or even cause a loss. So Future can probably rescind the agreement.

One type of mistake situation where it appears courts will not usually allow a party to avoid the agreement is where a bidder makes a mistake in business judgement. Suppose the bidder simply misjudges how much labor will be needed to do a job. Courts usually say bidders cannot avoid the agreement in that situation because the bidder assumes the risk of that kind of mistake. So the bidder cannot meet the third requirement to avoid contracts because of mistakes. The reason for this may be that making judgements like that is a crucial part of the bidder's business, and so is different from the kind of mathematical or clerical errors discussed above.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7, and Chapter 9 ("Performance and Discharge of Duties"), Section 9.8a contain further discussion of courts' reluctance to allow a party to avoid or not perform an agreement because it turns out to be harder than the party thought it would be.

(4) Failure to Read Carefully the Written Agreement -- Parties generally cannot avoid an agreement on the basis that they made a mistake because they failed to read carefully the written offer or agreement. The reason appears to be that, under the rules discussed above, each party assumes the risk of this kind of mistake. This is because everyone is generally expected to know what is in documents he signs!

However, there are two limits on this general rule, in some jurisdictions. These limits may apply where: (a) there is an adhesion contract; or (b) there is a prior oral agreement, and the written document the parties create to reflect the oral agreement does not conform to it. These limits will be discussed below.

This general rule about reading written agreements is very important. Because a person who fails to read carefully or understand an agreement generally cannot avoid it, a person who does not understand a written statement for some reason should always have someone else read and explain it. This is especially important in international contracts, where one or more parties may not be completely fluent in the language used in the contract. In that situation, it is essential that parties make sure they understand all aspects of the agreement, because it is so difficult to avoid agreements on the basis of a mistake caused by a failure to read and understand the agreement.

*** ***CASE STUDY 162***

FACTS Chhay worked at the Ministry. Using an interpreter, Chhay discussed purchasing 100 new computers for the Ministry from the Barang Company, a foreign company whose employees spoke English. One possible term Chhay and Barang discussed was that the payments could be made in six equal monthly installments starting at the time of delivery. The parties also discussed various other possible terms, but they did not reach a final agreement. However, Barang told Chhay that it would send him a proposed written contract to consider.

Within a few days the proposed written contract (an offer) arrived. The offer was completely in English. Because Chhay did not know English too well, he did not understand all of the offer, and his interpreter was not at work that day to explain it. However, the proposed agreement seemed to reflect the terms the parties had already discussed, and Chhay decided to sign it. He signed it and returned it to Barang.

Because Chhay did not understand all of the written contract, he did not notice that it actually required payment of the full purchase price of the computers to be made within one month of delivery. The Ministry cannot pay the money this quickly, and Chhay refuses to obey this part of the contract. Barang asks the court to enforce the agreement.

QUESTION OF LAW Can Barang enforce this agreement?

DECISION Yes. Barang can enforce this agreement because Chhay simply failed to read the written agreement he signed, and he cannot meet all the requirements to avoid the contract based on this unilateral mistake.

Where a party to an agreement makes a unilateral mistake, that party may avoid the agreement only if the party meets all four of the requirements described above. In this case, Chhay made a mistake by signing a computer purchase agreement that required the Ministry to make full payment within one month of delivery, even though the Ministry was unable to do that. Chhay's mistake was caused by his failure to make sure he understood the proposed written agreement (the offer). The law says that parties like Chhay generally assume the risk of mistakes like this. So even if Chhay can meet the other requirements to avoid the agreement--such as by showing the mistake would have a material effect--he cannot meet the third requirement. So he cannot avoid the agreement, and Barang can enforce it.

As noted above, there are two limits on the general rule that a party cannot avoid an agreement where he has made a mistake because of a failure to read or understand the written agreement. The first limit occurs where there is an adhesion contract. Adhesion contracts will be discussed in more detail in Chapter 8 ("Interpretation of Contracts"), Section 8.3i, and Section 7.7 of this Chapter, which explains unconscionability. However, adhesion contracts are basically agreements written completely by one party--the stronger party--and presented to the other party in circumstances where there is no real opportunity to negotiate about the terms. In other words, adhesion contracts are presented on a "take it or leave it" basis. The weaker party must "adhere" to the written proposal of the stronger party, or not make the agreement at all. For example, large companies often have very long standard form contracts that they use to deal with thousands of different customers. Often, it is not practical for these customers to read these entire contracts every time they wish to deal with the stronger companies. In this type of situation, many courts say that contract terms a reasonable weaker party would not anticipate, and to which such a party would not agree if he had known about them, are not part of the agreement. So in that situation, a party might be able to avoid part of an agreement he made because he failed to read or understand the written agreement. One way to explain this rule is that, where there is an adhesion contract, the law says the weaker party does not assume the risk of such a mistake, because that would be unfair. But this rule is applied only in very limited situations, as will be discussed in Chapter 8.

The second limit occurs where there is already an oral agreement between the parties, and the final written statement of the agreement does not conform to the terms of the prior oral agreement. That is, the written form does not correctly express the parties' real prior agreement. In that situation, the court will often reform (or adjust) the writing to reflect the real oral agreement of the parties. So in cases like that, the party does not assume the risk that a term to which he has already agreed--as part of a valid contract--is not correctly stated in the written contract. For example, in Case Study 162

above, if Chhay and Barang had already reached an oral agreement, including agreement about how payment would occur, then Chhay's failure to notice a different payment term in a written contract might not prevent him from having a court reform the agreement to reflect the real agreement.

However, this second limit applies only where the parties have a prior agreement about the term in question. If the parties' existing oral agreement is silent about the term in question, and a party fails to notice a new term in the written statement of the agreement, it appears that the party making the mistake cannot reform or avoid the agreement. Perhaps this is because the law believes parties do not assume the risk that the other party will change an existing term, but they do assume the risk that the written statement--which is usually more complete than an oral one--will include new terms that the party will not like. Another possibility is that the new terms in such a written statement are actually proposals to modify the existing agreement--and if a party signs the written statement, he agrees to the new proposals. In any event, this means that parties should read written agreements very carefully, even if they have a prior oral agreement. Reformation of agreements resulting from mistake will be explained in Section 7.3c below, and reformation in general will be discussed in Chapter 10 ("Remedies"), Section 10.7c.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3i discusses the legal effects of adhesion contracts, and Section 8.4 explains how courts use different types of evidence to determine contract terms where there appear to be both written and oral statements related to the agreement; and Chapter 10 ("Remedies"), Section 10.7c contains further discussion about reformation of agreements.

7.3c The Effects of Mistake: Restitution Is Generally Available, and Reformation May Be Possible

As discussed above, an agreement resulting from mistake may be voidable or void, depending on the circumstances. If such an agreement is voidable, the affected party can generally avoid or rescind the agreement. And of course, void agreements cannot be enforced.

Where an agreement results from mistake, restitution is generally available. Where the agreement is voidable, a party can generally recover the reasonable value of what he has provided to the other party under the agreement. The possible responses of parties to voidable contracts--including disaffirmance and ratification--were discussed in Chapter 4 ("Capacity"). In general, the rules discussed in Chapter 4 apply to contracts that are voidable because of mistake.

Parties can also generally get restitution if the agreement is void because of a mistake. For example, suppose two parties make an agreement for the sale of a specific subject matter, and one party pays for the item. But it turns out that the item was destroyed before the agreement was made.

That bilateral mistake would create a void agreement, which could not be enforced by either party. However, in that situation, the buyer would still be able to get restitution of what he paid to the seller.

Reformation is also a potential remedy where an agreement is voidable because of mistake. As noted above, reformation basically means that a court will adjust the agreement to fix the mistake, if that is possible. For example, as discussed in Section 7.3b above, where the parties sign a document that does not accurately state their prior oral agreement, a court may simply reform the document to accord with the parties' real agreement. This would actually create a valid agreement, but one that contained the correct term--not the incorrect term in the earlier document. Of course, this is only possible in some cases. For example, it would be difficult for a court to reform a void agreement to buy an item that did not exist, or a voidable agreement like the one in Case Study 158, where there was a mistake about the true identity of a party.

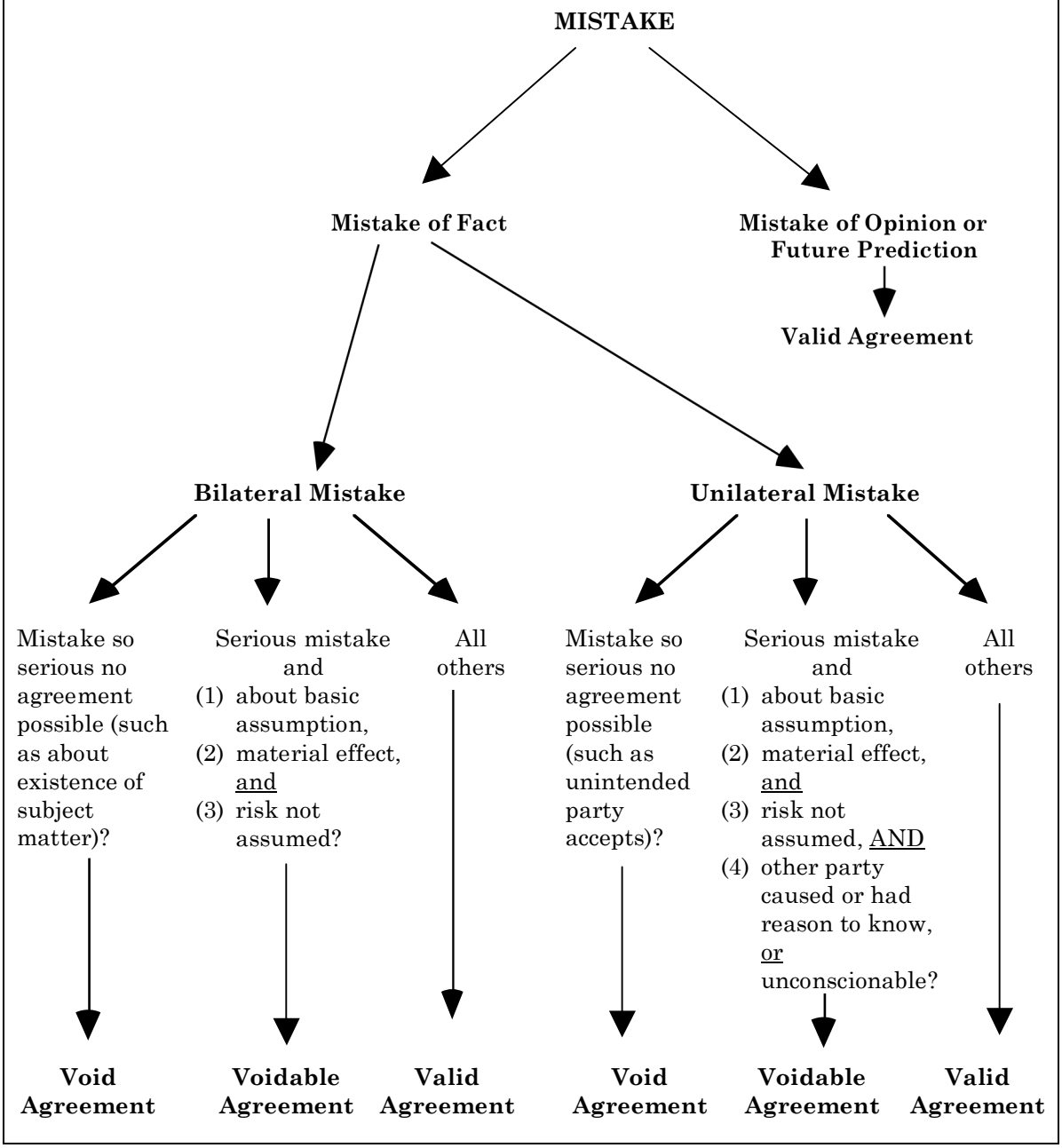
*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity") discusses the effects of voidable contracts in more detail; and Chapter 10 ("Remedies"), Section 10.7b discusses rescission, Section 10.7c discusses reformation of agreements, and the rest of the Chapter discusses other remedies.

7.3d Summary of Some Basic Rules about Mistake

The chart below illustrates some of the basic rules discussed in this Chapter about agreements resulting from mistake.

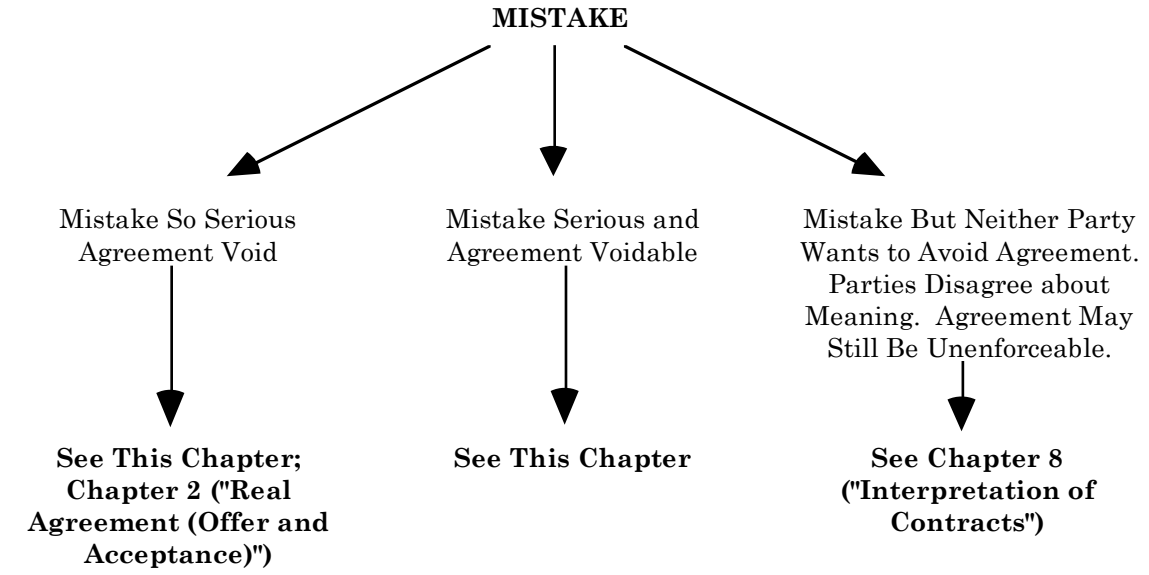


Illustration: Some Basic Rules about Agreements Resulting from Mistake



The following illustration shows where discussions of different kinds of mistakes are found in this text.

Illustration: Discussions of Mistake in This Text



7.4 Most Agreements Resulting from Misrepresentations of Material Facts Are Voidable

Sometimes one party makes an agreement because of a false statement or deceptive act of the other party to the agreement. An example is where a party selling a house tells a potential buyer that there is never any flooding around the house, when in fact there is bad flooding every rainy season! Statements like this are called misrepresentations.

*** **DEFINITION:** A **misrepresentation** is a statement that is not in accord with the facts.

When parties make agreements because of misrepresentations about material facts, the agreements may be void or voidable. Where there is a misrepresentation in the formation of an agreement--which basically means a party performs some deceptive act so that the other party has no reasonable opportunity to know the basic nature of the agreement--then the apparent agreement is void. Where there is a misrepresentation in the inducement of the agreement--which basically means that a party makes a false statement about a material (important) matter and the other party justifiably relies on the statement in making the agreement--then the agreement is voidable.

Misrepresentation may be fraudulent or innocent. The difference is that fraudulent misrepresentation occurs where a party intentionally misrepresents a material (important) fact, whereas innocent misrepresentation occurs where a party unintentionally misrepresents a material fact. It is possible that a party may make an "innocent" statement

of fact about an agreement that is actually false. This kind of misstatement occurs where the person making the statement honestly believes it to be true, but in reality it is not true.

Although misrepresentation may be fraudulent or innocent, the rules about the enforceability of agreements resulting from the two types of misrepresentation are very similar. The only difference is that it appears some courts do not require a showing that the injured party's reliance was justifiable where there is fraud.

However, many jurisdictions do say that fraud is a tort, and in some situations it may even be a crime. So although the status of contracts may not differ greatly based on whether misrepresentation is fraudulent or innocent, a party who commits fraud may have other legal problems.

As noted above, there are two basic kinds of misrepresentation: misrepresentation in the formation of the agreement, and misrepresentation in the inducement of the agreement. These two kinds are discussed below.

7.4a Agreements Resulting from Misrepresentation in the Formation Are Void

Sometimes a party to an agreement performs some deceptive act so that the other party does not really understand the basic nature of the agreement he is making. In this text, this will be called misrepresentation in the formation of the agreement. For example, this can occur if a party is about to sign a written agreement, but just before he signs, the other party substitutes another written agreement that looks similar but is actually different.

In many jurisdictions, if a party does not know or have a reasonable opportunity to know the basic nature of the agreement he made, because of this kind of misrepresentation, then the agreement is void. In these situations, a party is misrepresenting the nature of the agreement itself. Void agreements like this are similar to the ones discussed in Section 7.3a above, where there was a mistake so serious that no contract was formed. But it is important to remember that such agreements are not void if a party is merely careless about reading an agreement. For the agreement to be void, the party must show the court that he had no reasonable opportunity to know what the agreement was about. This rarely occurs.

******* ***CASE STUDY 163***

FACTS Kim Sean is shopping for a new motorcycle. She finally decides to sign an agreement to buy a motorcycle from a sales person named Rotana. Rotana shows Kim Sean a proposed written agreement for the sale of the motorcycle for $2,000. Kim Sean reads the agreement carefully and decides to sign it.

Just before Kim Sean is about to sign, Rotana's assistant brings Kim Sean some tea. As the assistant is placing the tea on the table in front of Kim Sean, some of the tea spills and splashes on the document. Rotana quickly gives Kim Sean a new written agreement to sign. The new agreement looks like the old one, and Kim Sean does not read it, since she already read the old one.

Kim Sean signs the new agreement. However, she soon discovers that the spilling of the tea was a trick, and that the new agreement says that the signer agrees to buy a $4,000 motorcycle! Kim Sean realizes she has been tricked, and she refuses to obey the agreement. Rotana asks the court to enforce the agreement.

QUESTION OF LAW Can Rotana enforce this agreement?

DECISION No. This agreement is void because Rotana committed misrepresentation in the formation of the agreement, and Kim Sean had no reasonable opportunity to know the nature of the document she signed.

When one party performs a deceptive act so that the other party does not know or have a reasonable opportunity to know the basic nature of the agreement he is making, there is misrepresentation in the formation of the agreement, and it is void. In this case, Rotana tricked Kim Sean into signing an agreement for a motorcycle she did not intend to buy. To do this, Rotana used the spilled tea to substitute a similar but different agreement for the one Kim Sean was about to sign. Since the agreement looked the same as the one Kim Sean had just read, she had no reasonable opportunity to know that one part was different. In this situation, Kim Sean had no reasonable chance to know the basic nature of the agreement she was signing. So the agreement is void, and Rotana cannot enforce it.

Where there is some innocent misrepresentation about the formation of the agreement, and a party does not know or have reason to know the basic nature of the agreement, any apparent agreement is void. For example, this might have occurred in Case Study 163. Suppose Rotana did not know that the agreement he was giving Kim Sean to sign after the tea spilled had different terms from the agreement she meant to sign. That would probably be an innocent misrepresentation in the formation, and the resulting agreement would be void. This kind of situation could also be analyzed as a mutual mistake resulting in a void agreement, as discussed in Section 7.3a above.

7.4b Agreements Resulting from Misrepresentation in the Inducement Are Voidable

As noted above, misrepresentation in the inducement basically occurs where one party to an agreement makes a false statement about an important matter and the other party justifiably relies on that statement in making

the agreement. If misrepresentation in the inducement exists, then the agreement is voidable.

The rules discussed in this Section are basically the same whether the misrepresentation is fraudulent or innocent. The reason for this appears to be that the law wants to encourage people to be sure about the facts before they make such representations--even when they do not intend to deceive others. It seems that the only real difference is that some courts do not require the victim of fraudulent misrepresentation to show that his reliance was justifiable, as discussed below.

This Section will first explain in more detail the basic rules about when agreements are voidable because of misrepresentation in the inducement. Then it will discuss the basic types of misrepresentation in the inducement.

(1) Basic Rules about Misrepresentation in the Inducement

Many jurisdictions say that misrepresentation in the inducement exists where:

(1) a party makes a misrepresentation (fraudulent or innocent) about an agreement;

(2) the misrepresentation is about a material fact;

AND (3) the other party to the agreement justifiably relies on that misrepresentation.

Each of these required elements is explained in more detail below.

(1) Misrepresentation -- A party makes a "misrepresentation" about a contract when that party makes a statement or causes a belief in the other party that has the goal of inducing the other party to agree to the contract. For example, if a seller of wood tells a potential buyer that the wood she is selling is mahogany, but the seller really has no idea what kind of wood it is, and after the contract is made the wood turns out to be a different kind, that is misrepresentation.

An important part of this requirement is that the party making the misrepresentation must have the goal of inducing the other party to make the agreement. For example, if the wood buyer in the example above merely asked a third party standing nearby what kind of wood was being sold, and the third party said "mahogany" merely because he wanted to appear knowledgeable, that would not be the basis for a claim of misrepresentation. The party making the misrepresentation must have some connection to the transaction.

It is also important to know that "misrepresentation" can include not only affirmative statements, but also concealing facts, or even failing to speak when the party has a duty to speak! These forms of misrepresentation will be discussed in more detail below.

(2) Material Fact -- A "fact" is something that is true about the present or the past. For example, the statement "I have earned $10,000 from this business this year" is a statement of fact. But statements about the future are not facts--they are merely predictions. So statements about the future cannot generally lead to misrepresentation. For example, a statement such as "this business will earn you $10,000 next year" is not a statement of fact.

In addition, misrepresentation cannot generally occur because of a statement of opinion. For example, the general rule is that if a sales person says that a certain car is "great" or "the best deal in the city," these statements are not misrepresentations. The reason for this rule is that the law believes persons who hear statements like this ought to realize that the speaker is not saying something on which the listener can rely--that is, the speaker is not stating a fact--but merely an opinion.

However, in the limited situations where the speaker has some special relationship to the other party, or special knowledge not available to the other party, then a misstatement of opinion may actually be misrepresentation! Such a special relationship may exist where there is a "fiduciary relationship." That basically means a relationship where one party is in a special position of trust and owes a special duty to act for the benefit of the other party. Examples include the relationship between a company and its shareholders, or between a lawyer and his client. So if a lawyer tells his client "I believe this contract is valid" when the lawyer does not really think so, this may be the basis for a claim of intentional misrepresentation. A misstatement of opinion may also be misrepresentation where one party has special knowledge not available to the other party. For example, if a computer expert examined a computer and told the owner "I think you need a new part" when the expert really did not think so, that may be the basis for a claim of misrepresentation. In these special situations, the person hearing the opinion has reason to believe that the speaker is basing his opinion on special knowledge. So the law says that incorrect statements of opinion in these situations may unfairly cause parties to make agreements as if they were statements of fact.

"Material" in this rule means something that is important to a party's decision to make or not make the contract. In this situation, a fact may be material if:

(1) it would induce a reasonable person to agree to a contract, or

(2) it was likely to induce the actual person involved to agree and the party making the misrepresentation knew that.

For example, if a moto seller tells a buyer that a particular moto has never been in a traffic accident, that may be important to a reasonable person's decision about whether to buy the moto, and so it may be material. If the seller tells the buyer the moto used to belong to a famous football star--knowing that the particular buyer is a passionate follower of football and the star--then this may be important to this particular buyer's decision to buy,

and so it may be material. This is true even though a "reasonable" person might not care whether a famous athlete owned the moto! This subjective standard depends on the actual expectations or beliefs of the specific parties, rather than the "reasonable" expectations of the parties.

(3) Justifiable Reliance -- In order to show misrepresentation in the inducement, a party must generally also show that he justifiably relied on the misrepresentation the other party made. Reliance in this situation means that the misstatement actually caused the other party to act to his own detriment, either by losing money or simply by failing to get the bargain he thought he was getting. So a party must first show that he actually did rely on the misstatement in making the contract.

In addition to showing that he actually did rely on the misstatement in making the agreement, the party must generally also show that it was justifiable that he do so. Whether reliance is justifiable basically means whether it is reasonable under all the circumstances. For example, if the moto sales person above told a potential buyer that a moto had never been in an accident, but the potential buyer could see that the moto was smashed up, the potential buyer would probably not be justified in relying on the sales person's statement. Some jurisdictions no longer require that a party show that his reliance was justifiable where the misrepresentation was intentional, perhaps to deter persons from intentionally making such false statements. In fact, it appears that the only significant difference between fraudulent and innocent misrepresentation is that all courts require parties claiming innocent misrepresentation to show that their reliance was justifiable.

Where all the above requirements above are met, the effect is that the agreement is voidable, and the injured party may avoid or rescind it. In that case, restitution is generally available. In addition, if the misrepresentation has caused other damage to the injured party, other remedies may be available. In particular, if the misrepresentation is fraudulent, then tort remedies such as punitive damages may be available. This will be explained in more detail in Chapter 10 ("Remedies"), Section 10.5d.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") discusses potential remedies where there are formation problems such as misrepresentation, and in particular, Section 10.5d discusses tort remedies that may available where there is fraud, and 10.7b discusses rescission.

(2) Types of Misrepresentation in the Inducement

There are many different situations where misrepresentation in the inducement may occur. These situations may be divided into two basic types:

(a) affirmative misrepresentation; and

(b) concealment or failure to disclose.

These situations will be discussed below.

(a) Affirmative Misrepresentation -- Affirmative misrepresentation is probably the most common type of misrepresentation. It occurs where one party involved in an agreement actually makes a statement--express or implied--to another party that meets the three requirements discussed above.

*** ***CASE STUDY 164***

FACTS Vandy works at the Ministry of Trains. It is her job to find a company to repair a number of locomotives which have been severely damaged. Eventually Vandy finds a company called the Right On Track Corporation which appears to have a good general reputation, appears to understand the project, and is willing to do the work for a reasonable price. During the negotiations, this company assures Vandy that it has successfully completed over 20 projects just like this.

After the Ministry and the company have signed a contract and the company has begun work on the trains, Vandy notices that the company's workers do not appear to know what they are doing. She telephones some people she knows in the industry, and learns that the company has in fact never done any work like this before! Vandy asks the court to allow the Ministry to rescind the contract.

QUESTION OF LAW Can the Ministry rescind this agreement?

DECISION Yes. The Ministry can rescind this agreement, because the Right On Track Corporation misrepresented a material fact: whether it had done work like the train repair project in the past.

When one party misrepresents a material fact, and another party justifiably relies on the misrepresentation in making an agreement, the agreement is voidable on the basis of misrepresentation in the inducement. In this case, the Right On Track Corporation told Vandy that it had successfully completed over 20 projects similar to the train repair project about which the parties were negotiating. However, this statement was false. The statement was about a material fact, since experience in the field is very important to any large project like this. And the Ministry relied on the statement in making the agreement. Its reliance was justifiable because it had no reason to doubt what the company told Vandy: the company had a fairly good general reputation and it appeared to understand the project.

So in this case, the Ministry can meet all the requirements of misrepresentation in the inducement, and can rescind the agreement. The Ministry would be able to get restitution of any payments made to Right On Track Corporation. And because this was fraud, tort remedies might also be available.

Affirmative misrepresentations may also be innocent.

*** ***CASE STUDY 165***

FACTS Narith is negotiating to buy a shipment of garments from Mona, the sales manager of the Haute Couture Textile Factory. Narith asks Mona whether the garments are made of silk. Mona believes that they are made of silk, and he tells Narith that they are.

However, after the garments are delivered, Narith discovers that they are not made of silk, but a material of lower quality. He asks the court to allow him to rescind the contract.

QUESTION OF LAW Can Narith rescind this agreement?

DECISION Yes. Narith can rescind this agreement because Mona misrepresented a material fact: whether the garments he was selling were made of silk.

When one party misrepresents a material fact, and another party justifiably relies on the misrepresentation in making an agreement, the agreement is voidable. In this case, Mona told Narith that the garments he was selling were made of silk, and Mona actually believed that to be true. However, it turned out to be false! In this situation, Mona made an unintentional misrepresentation about a material fact (the material of the clothes), and Narith justifiably relied on the misrepresentation in making the contract, since Narith had no reason to doubt what Mona told him.

So all the requirements are met for Narith to avoid or rescind the contract because of misrepresentation. Narith can return the clothes and recover any money he has paid.

(b) Concealment or Failure to Disclose -- When parties are negotiating a contract, there is generally no duty to disclose information to the other party. For example, in Case Study 164 above, the Right on Track Corporation would normally have had no duty to tell Vandy that it had never done the relevant kind of work before. That is, the company could have simply kept silent about its experience, and there would have been no misrepresentation.

However, there are several exceptions to this general rule. In these special situations, concealing material facts--or even failing to disclose them--can be misrepresentation in the inducement, even though the party makes no false affirmative statement! We will briefly discuss three situations where this can occur.

1. Active Concealment -- Sometimes a party actively conceals material facts from the other party to an agreement. This can be a form

of misrepresentation in the inducement, even though the party made no false statements. Consider the following Case Study.

*** ***CASE STUDY 166***

FACTS Sokhet wants to sell his house. However, there is a big hole in the wall of one room because of a bad leak in the roof. Sokhet and several friends put a huge cabinet in front of the hole, so potential buyers cannot see it.

A potential buyer named Nara makes a reasonable inspection of the house. Finally, he agrees to buy the house, unaware of the hole or the leak, and believing the house has no structural problems. Later, Nara discovers the hole and the leak. He says he will not obey the agreement.

QUESTION OF LAW Can Sokhet enforce this agreement against Nara?

DECISION No. This agreement is voidable by Nara because Sokhet's active concealment of the leak and the hole in the wall is misrepresentation in the inducement.

When one party to an agreement actively conceals a material fact, and the other party justifiably relies on his mistaken belief about that fact, misrepresentation in the inducement exists. In this case, Sokhet actually used a large cabinet to conceal the hole in the wall of his house which the leak in the roof caused. This was an active concealment of a material fact, because reasonable house buyers find it important whether houses have leaks in the roof and holes in the walls. In addition, Nara justifiably relied on the concealment in making the agreement, since he made a reasonable inspection of the house before agreeing to buy it, thinking it had no structural problems. So all the requirements for misrepresentation in the inducement exist, and the agreement is voidable by Nara. Sokhet cannot enforce the agreement.

2. Silence When a Party Has a Duty to Speak -- In a few special situations, parties have a duty to disclose information--a duty to speak even if they are not asked about something--and failure to speak in these situations may actually be a form of misrepresentation. Three of these situations are where there are fiduciary relationships; where past statements have become inaccurate; and where parties make mistakes about basic assumptions.

a. Where there is a fiduciary relationship between the parties to an agreement, even silence can be fraud in the inducement. This is because fiduciaries have a duty to disclose material facts. As noted above, a fiduciary relationship is one where one party--the "fiduciary"--has a duty to act for the benefit of another party, who places special trust in the first party. It is the fiduciary who has the duty to speak; a non-fiduciary party generally does not have this duty. Fiduciary relationships exist between partners in

a business firm, an agent and principal, a lawyer and client, a guardian and ward, a doctor and patient, and in many other situations.

For example, suppose an attorney made an agreement to provide an existing client with additional legal services, intentionally failing to tell the client that those services were a waste of money because the legislature had just recently changed the law. This could be fraudulent misrepresentation, because it is a failure to disclose a material fact. In that situation, the client could probably avoid the contract.

b. Another situation where there may be a duty to disclose is where one party has made past statements that have become inaccurate, even though they were true at the time the party made them. If the party who made the past statement fails to tell the other party that the statement is no longer true, it may be misrepresentation in the inducement.

*** ***CASE STUDY 167***

FACTS Suppose the story in Case Study 166 happened in a somewhat different way. In the new story, there is no leak in the roof or hole in the wall of Sokhet's house. And when Nara comes to look at the house, Sokhet tells him truthfully that there are no structural problems with the house, and that the roof is in good condition.

Unfortunately, a few days later a bad storm blows half of the roof off the house! Although Sokhet knows this, he fails to tell Nara when the parties get together to negotiate and sign the final agreement one week later. When Nara later learns about the damaged roof, he asks the court to help him rescind the contract.

QUESTION OF LAW Can Nara rescind this agreement?

DECISION Yes. Nara can rescind this agreement, because Sokhet failed to disclose that his prior true statements about the condition of the house had become false.

When one party to an agreement has a duty to disclose material facts, that party fails to do so, and the other party justifiably relies on the false belief caused, misrepresentation in the inducement exists. In this case, Sokhet at first truthfully told Nara that the house he was selling had no structural problems. However, a few days later there was a bad storm which damaged the roof, and Sokhet's prior statement was no longer true. But Sokhet did not disclose this to Nara. This is misrepresentation in the inducement, because Sokhet had a duty to tell Nara that his past statement about material facts (the lack of structural problems) had become false, and because Nara justifiably relied on his belief about these facts in making the agreement. In that situation, misrepresentation in the inducement exists, and Nara can rescind the agreement.

c. Finally, there may be fraudulent misrepresentation in the inducement where one party is mistaken about a basic assumption. Specifically, such misrepresentation may exist where:

(1) one party actually knows that the other party is making a mistake about a basic assumption related to the agreement;

(2) that first party fails to disclose this to the mistaken party;

AND (3) this is a failure to act in good faith and according to reasonable standards of fair dealing, based on all the circumstances of the case.

This is a very limited exception, because one party must actually know that the other party is making a mistake about a basic assumption, and the court must find that the failure to disclose the mistake was a failure to act in good faith and in accord with reasonable standards of fair dealing. What is "good faith" and "fair dealing" varies in different situations. "Good faith" was briefly discussed in Chapter 3 ("Consideration"), Section 3.6a. It basically means a party's honest conduct and not seeking unfair advantage over another party. Standards of "fair dealing" vary in different situations, but they basically mean fair conduct in the type of transaction involved. For example, a customer might look at a jewel dealer's unlabelled stone and say "what a beautiful emerald!" But if the jewel dealer knows the stone is actually a different, less valuable type of stone, the jewel dealer's failure to tell the customer of this mistake might be a failure to act in good faith and according to reasonable standards of fair dealing. These rules are somewhat similar to the rules about unilateral mistakes, although there are some different requirements. Unilateral mistake was discussed in more detail in Section 7.3b of this Chapter. Good faith and fair dealing will be further discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and Chapter 9 ("Performance and Discharge of Duties"), Section 9.5b.

Even though there may be a duty to disclose material facts in the above special situations, it is important to remember that silence when a person has no duty to speak is not misrepresentation. So if the customer in the example above offered to sell the jewel dealer a different gem for $500--but the merchant knew that it was actually worth $15,000--the dealer's superior knowledge of the stone's value does not by itself impose a duty for the dealer to speak. Unless some special situation creates this kind of duty for the dealer, the dealer has no duty to tell the customer that the gem is worth more.

3. Half-truths -- If a party tells only part of the truth, and this part creates a false impression about other facts, then this "half truth" may be misrepresentation--even though the statement made was true! For example, suppose the company in Case Study 164 had told Vandy that it had a lot of experience because it had been awarded 20 similar contracts in the past, and this was true. The statement could still be misrepresentation if the real fact was that the company had never successfully completed any of the projects!

In that situation, telling "half" of the truth creates a false impression, and it may be misrepresentation in the inducement. This type of misrepresentation would appear to be rare. And of course, whether it exists depends on all the circumstances in each situation.

*** ***WHY IS THIS IMPORTANT?*** Why can concealment or even failure to disclose material facts be misrepresentation in certain limited situations, even though there is generally no duty to disclose such facts?

In general, the law does not require that parties to contracts disclose all material facts to other parties. If the law did require that, it would probably be a huge burden on trade. Such a rule would force most business persons to spend a lot of their time trying to determine all the important features of their products--bad and good--and making sure their customers knew about them. It is difficult to imagine a competitive economic system where businesses would be forced to make public all the weaknesses in their products. In addition, if there were a general duty to disclose, courts might be overwhelmed with parties complaining that other parties had failed to tell them something about a particular agreement. And it might be very difficult in many cases to decide how much a party should be required to disclose. All of this would take a great deal of time and resources. And it might not encourage parties to be careful about the agreements they make, which is one of the main goals of free market contract law.

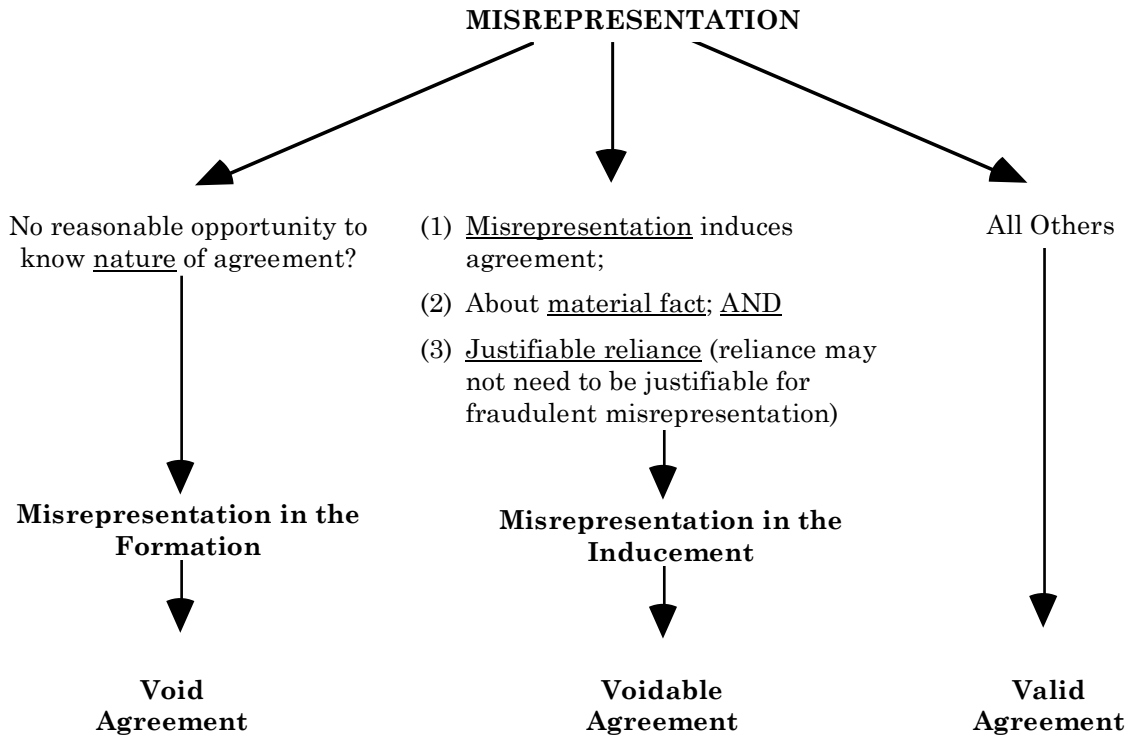
However, in certain special situations, the law does require that parties disclose material facts, and does say that failure to do so can be misrepresentation. These special situations basically occur where one party is actively trying to take advantage of the other (such as through active concealment or half-truths) or failing to meet basic standards of fairness (such as by failing to correct known mistakes about basic assumptions). When that happens, the law believes it would be unfair to allow one party to take advantage of the other party, and to offer the other party no protection at all. So the law makes this limited exception to the general rule: the law says that failure to disclose the material facts involved in such situations can be misrepresentation, and the party who is the victim of the misrepresentation can avoid the contract.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c discuss the duty of good faith and fair dealing.

7.4c Summary of Some Basic Rules about Misrepresentation

The chart below illustrates some of the basic rules discussed in this Chapter about agreements resulting from misrepresentation.

Illustration: Some Basic Rules about Agreements Resulting from Misrepresentation



7.5 Agreements Resulting from Duress Are Voidable

When a party uses an improper threat to induce another party to make an agreement, the agreement is made under duress, and it is voidable.

*** **DEFINITION: Duress** is the use of an improper threat to induce a party to do something the party would not otherwise do.

An example of an improper threat would be a situation in which Phally threatened to kill Molika with a gun if she did not sell him some land he wanted. This agreement would be the result of duress, and it would be voidable by Molika. The threat need not involve violence to be duress. For example, it may be a threat to commit a non-violent tort such as defamation.

The reason for this rule is that a party suffering duress has not voluntarily consented to the agreement--it was not made of the party's "free will." This is true even though it may look like there was an offer and acceptance, under the objective standard for "real agreement."

Two elements are required for duress to exist with regard to an agreement:

(1) one party makes an improper threat;

AND (2) the threat actually induces another party to make an agreement.

To be improper, a threat must generally be a threat to harm the person, family or property of the victim. So duress need not be aimed directly at the contracting party in order to be duress. In addition, the person making the threat need not be a party to the potential contract. For instance, in the example above, if Phally's father threatened to kill Molika if she did not sell the land to Phally, that would still be duress.

It could also be argued that a threat to harm other persons--not just family members--might be an improper threat that could unfairly induce a party to make an agreement, at least in certain situations. For example, if a guerrilla group kidnaps persons and threatens to harm them if a government does not make some agreement with the guerrillas, it certainly seems that any such agreement should be voidable because of duress. However, it is not clear how many jurisdictions would accept that argument. Of course, many such agreements might be also be unenforceable because of illegality, perhaps because they promote immorality. And common law jurisdictions might consider some such agreements to be based on legally unenforceable promises, and to lack consideration. That might occur where one party's promise was a promise not to do something the party had no right to do anyway, such as harm a kidnapped person. This was discussed in Chapter 3 ("Consideration"), Section 3.5b.

Duress is measured by a subjective standard, like several other contract formation problems discussed in this Chapter. That is, for duress to exist, the improper threat must have actually caused the specific victim to make the agreement. It does not matter whether the threat would have caused a reasonable person to make the agreement or not. For example, a party may threaten to slap another person's face if that person does not sell him a new car for $50. If the car owner is very timid, and this threat actually causes him to make the agreement, the agreement is voidable because of duress. This is true even though the average person might have been able to resist the threat.

The effect of an agreement made under duress is that it is voidable by the party who is the victim of the duress. This means that the victim can avoid or rescind the agreement. But the party responsible for the duress cannot avoid the agreement. The victim can also recover restitution of whatever he has transferred to the other party under the agreement. These potential remedies for voidable contracts were discussed in Sections 7.3 and 7.4 above.

7.5a Forms of Duress

Improper threats may take many forms. They may be express or implied. In general, threats are improper if they are threats to commit crimes or torts--violent or non-violent--that will harm the victim, his family or his property. The following are examples of types of threats that may lead to contracts that are voidable because of duress:

(1) threats to start criminal litigation against the victim or his family, which is an abuse of the courts and often a crime in itself;

(2) threats to start civil litigation against the victim or his family without a legitimate basis, which may also be the tort of malicious prosecution;

(3) threats to disclose embarrassing facts about a person to others, which is the crime of blackmail;

(4) threats not to perform contracts where the threats are intended to obtain a contract modification, and there is no legitimate commercial reason for the threat; this violates the duty of good faith, and is also a tort in some jurisdictions;

(5) threats not to trade or deal with a party in the future, in limited situations where those threats violate trade or antitrust laws.

The improper threats listed above are threats to do things that violate criminal or civil law. Authorities do not appear to agree about whether a threat to do something that does not actually violate the law may be duress. Some authorities argue that even a threat to exercise legal rights in "oppressive ways" may be duress. Others say that, even though a variety of threats may lead to duress, it is always based on criminal or civil wrongs of some kind, and that it may only appear to be otherwise because the list of such wrongs grows longer as time passes! In any event, it appears that most if not all improper threats are threats to commit crimes or civil wrongs.

Not all threats are "improper." The threat to bring a legitimate civil action against a party is not usually duress. For example, suppose there is a bad accident on the road, and one party threatens to bring a tort lawsuit for compensation for his injuries. That is not an improper threat. So if the "threatened" party agrees to pay the threatening party a certain amount of money in return for a promise not to bring a lawsuit against him, that is not an agreement resulting from duress--it is the legitimate settlement of a legal dispute.

In addition, many threats that may seem like "economic duress" are not improper. Although examples (4) and (5) above are situations where "economic" duress may exist, there are few situations like that. For example, hard bargaining about an agreement is not duress. So if one party threatens to stop contract negotiations if the other party insists on a certain

contract term, that is not generally an improper threat, since the "threatening" party generally has a right to insist on whatever contract terms he wishes.

The following Case Studies illustrate some of the possible forms of duress.

*** ***CASE STUDY 168***

FACTS Sophyt wants a new mobile phone very badly. However, Mean, the phone company sales person, will not sell Sophyt a phone because Sophyt has only $100, which is not enough money. Sophyt tells Mean that if Mean will not sell him the phone for $100, Mean's young daughter may not remain healthy for much longer. As a result, Mean agrees to sell Sophyt the phone for $100.

After hiding his daughter in a safe place, Mean tells Sophyt that he will not obey the agreement. Sophyt asks the court to enforce the agreement.

QUESTION OF LAW Can Sophyt enforce this agreement?

DECISION No. Sophyt cannot enforce this agreement because it is the result of his improper threat to harm Mean's daughter, and that is duress.

When one party induces another party to make an agreement through use of an improper threat, the agreement is made under duress, and it is voidable by the party who has suffered the duress. In this case, Sophyt told Mean that if he did not sell Mean the phone for $100--far less than its real price--then Mean's daughter might not remain healthy much longer. This is an improper threat. Even though Sophyt has not actually said "I will harm your daughter unless you sell me the phone for $100," his words have clearly communicated that threat, under these circumstances. So in this situation, the agreement was made under duress, and it is voidable by Mean. Sophyt cannot enforce the agreement.

*** ***CASE STUDY 169***

FACTS Paet is shopping for a new moto because he needs to travel often. While Paet is looking at all the used motos for sale at Rin's Moto Shop, he sees Rin buying a whole truckload of what appear to be stolen motos. Paet threatens to report Rin to the police and have him prosecuted for buying stolen goods, which is a crime, unless Rin will sell him a new $1,000 moto for $50. Rin agrees, but later decides not to obey the agreement. Paet asks the court to enforce the agreement.

QUESTION OF LAW Can Paet enforce this agreement?

DECISION No. Paet cannot enforce this agreement because it is the result of his improper threat to have Rin prosecuted for buying stolen goods, and this kind of threat of criminal prosecution is duress.

When one party induces another party to make an agreement through use of an improper threat, the agreement is made under duress, and it is voidable by the party who has suffered the duress. In this case, Paet threatened to have Rin prosecuted for buying stolen motos if Rin did not sell him a $1,000 moto for only $50. This is duress, because threatening someone with criminal prosecution is an improper threat, and this threat caused Rin to make the agreement. So the contract is voidable by Rin, and Paet cannot enforce it if Rin chooses not to proceed.

The result in Case Study 169 is the same even if Rin actually is guilty of buying stolen goods! The reason appears to be that, even though the courts want to punish those who break criminal laws, they do not wish to help parties blackmail others, or use the criminal justice system for private gain. Enforcing such agreements might also put courts in the position of enforcing agreements not to report crimes, and might encourage witnesses of crimes to commit blackmail rather than provide evidence to the police. This would be an abuse of the judicial system.

Another important type of duress occurs where one party improperly threatens not to perform an existing contract in order to get another party to agree to a contract modification for which there is no legitimate commercial reason. An example of a legitimate reason might be that goods were damaged on the way from the seller to the buyer, or that some event made performance of the contract much more difficult than either party could have foreseen. In many jurisdictions, improper threats not to perform existing contracts are a breach of the duty of good faith in the performance of the contract. A duty of good faith and fair dealing is implied in all contracts in many jurisdictions. It was discussed above in Section 7.4b, and it will be discussed in more detail in later Chapters. One jurisdiction has said that the duty of good faith basically means that all parties have a duty not to do anything to impair the ability of the other parties to receive the benefits of the agreement. In any event, where one party threatens not to perform an existing agreement unless the other party agrees to a modification that has no legitimate commercial reason, this violates the duty of good faith, and it is duress. And in some jurisdictions, it is also a tort.

*** ***CASE STUDY 170***

FACTS Suppose that the story in Case Study 99 happened in a slightly different way. In Case Study 99, a moto driver named Samnang agreed to take Sapor to Wat Phnom for 1,000 riels. But on the way to the Wat, while Samnang and Sapor were traveling through a deserted part of the city, Samnang asked Sapor for more money.

In the new story, instead of simply asking Sapor for more money, Samnang threatens to leave Sapor by the deserted road side if she does not agree to give him 3,000 riels in return for Samnang giving her the ride and two cigarettes. Sapor agrees. But once they reach the Wat, she refuses to give Samnang any more than 1,000 riels, and tells him that she hopes he dies from his cigarettes. Samnang asks the court to enforce the modified agreement.

QUESTION OF LAW Can Samnang enforce the modified agreement?

DECISION No. Samnang cannot enforce the modified agreement because it is the result of his improper threat to breach his existing contract to take Sapor to the Wat, and this kind of threat is duress.

When one party induces another party to make an agreement through use of an improper threat, the agreement is made under duress, and it is voidable by the party who has suffered the duress. In particular, duress occurs where one party threatens not to perform an existing contract in order to get another party to agree to a contract modification for which there is no legitimate commercial reason.

In this case, Samnang threatened not to perform his contract with Sapor--and leave her by the road side in a deserted part of the city--unless she agreed to pay three times as much money, in exchange for the same moto ride plus two cigarettes. This is duress, because it is an improper threat not to perform an existing contract unless Sapor agrees to a modification with no legitimate commercial purpose. So the modification is voidable, and Samnang cannot enforce it.

It is important to note that, in Case Study 99, where Samnang simply asked Sapor for more money for the same trip, the modification was unenforceable in common law jurisdictions because there was no new consideration. In Case Study 170, there is new consideration, because Samnang has agreed to do something new--give Sapor two cigarettes. But Samnang still cannot enforce the agreement, because it was the result of an improper threat, and was therefore duress.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7 discusses the common law requirement of consideration for modifications of existing contracts; Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c discuss the duty of good faith and fair dealing.

7.6 Agreements Resulting from Undue Influence Are Voidable

Sometimes one party has so much power over another party--because of a relationship of trust or some other factor--that the weaker party is unable to use his free will in making an agreement, and an unfair contract occurs.

This occurs even though the weaker party has capacity and no threats are made. For example, a very dominating parent may be able to influence a very timid adult child to make an unfair agreement, even though the child has capacity and the parent makes no threats. Common law jurisdictions call this undue influence. In those jurisdictions, it results in an agreement that is voidable by the weaker party. It appears that many civil law jurisdictions do not apply the specific doctrine of undue influence. But those jurisdictions may have comparable ways to protect parties in these situations, as discussed in Section 7.9, below.

*** **DEFINITION: Undue influence** is the improper influencing of a party to make an unfair contract, often through a relationship of trust or confidence, even though no threats are made.

A party must generally show two important elements in order to avoid a contract because of undue influence:

(1) improper influence of a weaker party;

AND (2) an unfair agreement.

The party claiming undue influence must generally show that the other party actually did improperly influence the weaker party to make the contract, and that the weaker party was unable to use his free will in making the agreement. Undue influence usually occurs as the result of a number of commonly recognized relationships where one party puts special trust and confidence in another party, and where the first party may therefore be vulnerable to the other party. Generally these are called fiduciary relationships, as explained in Section 7.4b above. Examples include the relationships between family members (especially parents and children), and between accountants, lawyers, nurses, and doctors and their clients or patients. But the mere existence of such a relationship does not mean there is automatically undue influence in an agreement. This is because, as noted above, the party claiming undue influence generally must show that there actually was improper influence. But some authorities do say that, where there is a fiduciary relationship, any unfair agreement is voidable because of undue influence--whether the stronger party improperly influenced the weaker party or not.

It appears that undue influence can also occur even when there is no recognized relationship of trust, such as those described above, but where one party is still in a position to take advantage of another party. For example, where a party is seriously ill, intoxicated, or in some other distress, even a party who is not in any of the recognized categories above may be in a position to dominate the weaker party and use undue influence to make an unfair contract. Of course, in some of these situations, the weaker party may also lack the capacity required to make a valid contract.

Another important aspect of undue influence is that the agreement must actually be unfair to the weaker party for undue influence to exist. This element is not required for parties to avoid contracts on the basis of most other contract formation problems. What is "unfair" can be very difficult for a court to decide. It will depend on all the circumstances of a particular transaction. In general, agreements are probably "unfair" if there is a significant difference between the consideration on each side. For example, if an accountant convinces a client to sell him property worth $20,000 for only $10,000, that is probably "unfair."

The effect of an agreement made because of undue influence is that the agreement is voidable by the weaker party. The weaker party can avoid or rescind the agreement, and can get restitution of what he has given to the other party under the agreement.

*** ***CASE STUDY 171***

FACTS Socheatra was advanced in years, ill, and totally dependent on her son Banh for support and care. Socheatra did have the capacity to make contracts, although she depended on Banh for advice about financial and other matters.

On several occasions, Banh made very insistent offers to buy Socheatra's house for $1,000, even though the house was worth $50,000. Although Banh made no threats, Socheatra became very concerned that if she did not agree to this contract, Banh might stop caring for her, or at least not do a very good job. Finally, Socheatra agreed to sell Banh the house for $1,000.

However, after speaking with her daughter, Socheatra decided she did not wish to obey the agreement. Banh asks the court to enforce the agreement.

QUESTION OF LAW Can Banh enforce this agreement?

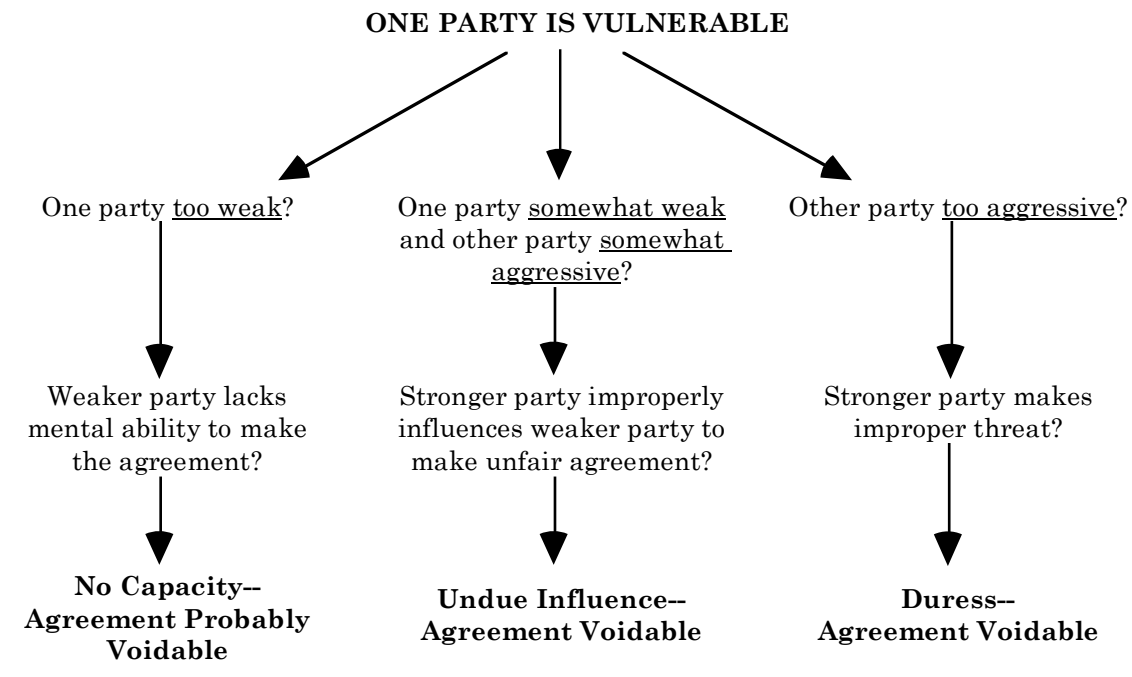
DECISION Probably not. Banh probably cannot enforce the agreement because it appears to be the result of his undue influence on his dependent mother.

Where one party uses improper influence to induce another party to make an unfair agreement, the agreement is voidable by the weaker party, because it is the result of undue influence. In this case, Banh made several persistent offers to buy the house of his dependent mother Socheatra for $1,000, a price that was far below the real value of the house. Although Banh made no actual threats to Socheatra, and Socheatra had capacity, Socheatra became afraid that Banh would no longer care for her if she did not agree. So she agreed. This situation is probably undue influence. Banh used his position of trust and confidence--as his mother's son and care taker--to influence her to make an unfair contract. Therefore, the agreement is

probably voidable by Socheatra. Banh probably cannot enforce it if Socheatra chooses not to proceed.

Some authorities say that undue influence actually fills a gap between capacity and duress as a basis for avoiding a contract. Capacity, undue influence and duress all try to protect parties who may be vulnerable to others in making an agreement. This protection may be needed because of the very aggressive behavior of the stronger party (as with duress), the vulnerability of the weaker party (as with capacity), or a combination of the two (as with undue influence). So where a vulnerable party was not weak enough to lack capacity, and where the other party was not so aggressive that he actually used duress, a vulnerable party may still be able to avoid an unfair agreement on the basis of undue influence, if the agreement was basically the result of a combination of his weakness and the other party's aggressiveness. Capacity was explained in detail in Chapter 4 ("Capacity"), and duress was explained in Section 7.5, above. The following chart illustrates the relationship between these three important methods many courts use to protect vulnerable parties to contracts.

Illustration: Comparison of Capacity, Undue Influence and Duress



*** ***ADDITIONAL REFERENCE:*** Chapter 4 ("Capacity") contains a more complete discussion of when agreements may be unenforceable because one party lacks the mental competence to make the agreement.

7.7 In Very Limited Situations, Courts May Refuse to Enforce Agreements Because They Are Unconscionable

Sections 7.3-7.6 discuss contract formation problems that affect whether there really is a knowing and voluntary agreement between parties. This Section discusses the very limited situations where courts may refuse to enforce all or part of an agreement simply because the process of formation or terms of the agreement are too unfair to one party.

7.7a An Agreement May Be Unconscionable Where Its Process of Formation or Terms Are So Unfair That It Shocks the Conscience of the Court

Free market courts rarely refuse to enforce agreements simply because they are "unfair." However, where the process of formation or terms of an agreement are so unfair that they shock the conscience of the court, the court may refuse to enforce the unfair terms or the entire agreement. When this limited kind of situation occurs, common law jurisdictions say that the agreement is "unconscionable."

*** **DEFINITION: Unconscionable** agreements are basically agreements whose process of formation or actual provisions are so unfair to one party that they shock the conscience of the court.

A possible example of an unconscionable agreement would be where an aggressive sales person convinces a barely literate person who does not have much money to sign a long pre-printed form agreement for the sale of a television worth $200. The document says the price is "$20 per month," but provisions in very small print state that the monthly payments will continue for three years--for a total price of $720. Even in a case like this, the agreement is only unconscionable if the court finds that it is so unfair that it is shocking!

If all or part of an agreement is unconscionable, common law courts will not enforce the unconscionable part of the agreement, and so it appears that part is void. It appears that many civil law jurisdictions do not apply the specific doctrine of unconscionability. But such jurisdictions may have comparable ways to protect parties in such situations, as discussed in Section 7.9, below.

Authorities and courts do not agree about the exact nature of what is unconscionable, nor about when this rule should be used to refuse enforcement of an agreement. In fact, this is a very confused area of the law, and it is difficult to make clear statements about it.

In general, authorities do agree that the rules about unconscionability should be used rarely, only in the most extreme circumstances. And they agree that unconscionability depends on the nature of the agreement,

especially its general commercial background, and the other surrounding circumstances. These factors are measured at the time the agreement is made, and not at some later time, such as during performance. Unfairness in performance and other performance problems will be discussed in Chapter 9 ("Performance and Discharge of Duties").

Some authorities say that unconscionability occurs where an agreement is extremely "one-sided," often because of a great difference in bargaining power between the parties with respect to the specific transaction. That could occur where one stronger party drafts the agreement and the other party has little ability to really negotiate about it. And many say that the real purpose of the rule about unconscionability is to protect parties from "oppression" and "unfair surprise"--and not to help parties avoid what is simply a bad bargain. Because of the purpose of the rule about unconscionability, it seems that it is generally used to help individual consumers, and less used to help businesses. Businesses may often have more trouble showing that they were victims of extremely unfair agreements.

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties") contains a more complete discussion of problems related to the performance of agreements, including unfair behavior.

*** ***WHY IS THIS IMPORTANT?*** Why do common law courts refuse to enforce agreements in the very limited situation where they are unconscionable, despite the general rule that courts do not refuse to enforce contracts simply because they are "unfair?"

Courts in free market jurisdictions do not generally refuse to enforce agreements simply because they are "unfair." As discussed in other Chapters, such as Chapter 3 ("Consideration"), Section 3.4, if courts were to refuse to enforce contracts simply because one party claimed to have a "bad deal," or claimed that the consideration on one side was "unequal," courts might be overwhelmed with contract disputes. Parties could not rely on their agreements, and the free market economy might not be able to function efficiently. In addition, courts do not wish to "rewrite" contracts parties make, because this would interfere with the freedom of contract. So free market courts generally let the parties decide what is an appropriate bargain, and do not refuse to enforce contracts simply because they may be "unfair."

However, in certain very limited circumstances, courts make an exception to this important general rule. Some types of unfairness are so extreme that they "shock the conscience of the court." Many courts will not enforce agreements like that. Even in free market societies--where most people believe that the free market and freedom of contract lead to greater development and prosperity for most people--the law believes that some limits must be placed on these freedoms, in order to make sure that they do not cause great injustice in particular cases. Of course, it can be hard to say exactly when contracts are so unfair that they meet this standard! So courts use the

rules on unconscionability only in limited situations, when it is clear that parties are unable to protect themselves from being victimized to a great degree by stronger parties. Most parties, in most situations, cannot meet this difficult standard.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.4 contains discussion of why common law jurisdictions generally do not require that consideration be "equal" on both sides of an agreement.

In some ways, unconscionability is similar to undue influence, which also tries to protect parties who make unfair contracts, and which was explained in Section 7.6 of this Chapter. But where undue influence is based on a showing of improper influence on a weaker party, usually by a party in some special position of trust, unconscionability is based only on a showing of extreme unfairness, either in the way the agreement was formed, or the actual terms of the agreement, or both. So it appears that unconscionability requires a greater showing of unfairness, whereas undue influence requires a showing of improper influence. Of course, there is some overlap between the two claims. And it seems possible that an agreement could be the result of both undue influence and unconscionability at the same time. The following chart compares these two methods courts use--rarely--to protect parties who make contracts that are unfair to them.

Illustration: Comparison: Undue Influence and Unconscionability

	UNDUE INFLUENCE	UNCONSCIONABILITY
1. What is wrong with the agreement?	Improper influence on a weaker party, often by another party in a position of trust	Extreme unfairness in the process of formation or actual terms of an agreement or both
2. Status of "victim?"	Victim is weaker and vulnerable to influence by stronger party	Victim has much less bargaining power in the specific transaction
3. How "unfair" must agreement be?	Unfair	Extremely unfair
4. Will court enforce against "victim"?	Not if victim chooses to avoid, since agreement is voidable	No--unconscionable part of agreement appears to be void
5. Key Differences	(a) Designed to fight improper influence on weaker parties (b) Requires unfairness	(a) Designed to fight extreme unfairness (b) Requires extreme unfairness

7.7b Forms of Unconscionability

In many jurisdictions, there are two basic types of unconscionability: procedural unconscionability and substantive unconscionability. Procedural unconscionability is caused by unfairness in the way the agreement is formed. Substantive unconscionability is caused by unfairness in the actual terms of the agreement. It seems that an agreement may be unenforceable because of either one of these types, although some authorities believe that an agreement is unlikely to be considered unconscionable unless some elements of both types are present. In any case, this text will examine the two types of unconscionability separately.

(1) Procedural Unconscionability Is Extreme Unfairness in the Process of Formation of an Agreement

Procedural unconscionability is extreme unfairness in the way the agreement was formed. It occurs where one party was induced to make the agreement without having any real choice or ability to bargain about the terms.

Procedural unconscionability can happen where one party has so much greater bargaining power that he is basically able to dictate the terms of the agreement, even if the other party does not really wish to agree to those terms. Sometimes the party with less bargaining power may have no way to obtain the subject matter of the agreement except on the more powerful party's terms. In addition, the less powerful party may not really know or understand some of the terms, although as explained in Section 7.3b, parties cannot generally avoid agreements merely because they failed to read or understand them. Despite this general rule, the weaker party's lack of understanding in this special situation may help to show procedural unconscionability. Often the less powerful party is not experienced or knowledgeable about the kind of transaction being made. The stronger party may know this and take advantage of it, with an aggressive sales technique and complex terms that are hard to understand. The stronger party may also know that the other party will have difficulty getting real benefits from the agreement, perhaps because of the financial situation of that party.

Where there is procedural unconscionability, courts may refuse to enforce some or all of the agreement. However, as noted above, this is much more likely if there are also elements of substantive unconscionability.

Procedural unconscionability is possible particularly where there are adhesion contracts. These contracts were discussed above in Section 7.3b, and they will be discussed again in Chapter 8 ("Interpretation of Contracts"), Section 8.3i.

*** **DEFINITION: Adhesion contracts** are contracts written completely by a party who has much greater bargaining power, and presented to the other party in circumstances where there is no real opportunity to negotiate about the terms, which are usually standardized, difficult to understand, very favorable to the stronger party, and in small print.

As discussed above, adhesion contracts are presented on a "take it or leave it" basis, generally by a party with much greater bargaining power than the other party. The weaker party is basically forced to "adhere" to the written proposal of the stronger party, or not make the agreement at all. For example, large companies--such as insurance companies or car rental companies--often have long standard form contracts that they use to deal with thousands of different customers. Often, it is not practical for these customers to read these entire contracts--and certainly not to negotiate the contracts--every time they wish to deal with the stronger companies. And these form contracts may be very difficult for the average person to understand.

Bargaining power is measured by the particular transaction. So parties who may have power in some transactions may still be unable to negotiate about terms in other transactions. For example, even a wealthy person may face the same adhesion contract when doing certain activities, such as buying insurance.

*** ***CASE STUDY 172***

FACTS Yos sells insurance for the World Wide Insurance Company, a very large seller of property insurance with an office in Phnom Penh. One day, Yos goes to visit Many, who lives in a small village outside of the city and who cannot read very well.

Yos is a very skilled and persuasive sales person, with years of experience in insurance. She tells Many that he really should have insurance for his house, because the rainy season is coming and the house could easily be damaged by flooding. She tells him that he can get a comprehensive insurance policy to cover damage to his house, for only $10 per month. She shows Many a very long, complex, pre-printed World Wide home insurance policy with a one year term. She writes "$10 per month" in one of the few blank spaces in the policy, inviting Many to sign so he will not have to worry about his house any more. Many can read the "$10 per month" part of the agreement, and he believes that Yos has a good product for such a low price. So he signs the agreement.

Later, Many shows the agreement to his friend Saumura, who is a student of contract law. Saumura begins to read the contract, and when she has finished two hours later, she tells Many that one part of the contract actually says that, while the policy covers "flood damage," it does not cover "flooding directly caused by rain"--which is by far the most likely way Many's house could be damaged, and the only reason he bought the insurance policy!

Many decides he does not need this kind of insurance, and he refuses to pay any premiums. The World Wide Company asks the court to enforce the agreement.

QUESTION OF LAW Can World Wide enforce this agreement?

DECISION Probably not. World Wide probably cannot enforce this agreement as it is written because it is unconscionable.

Where one party makes an agreement whose process of formation is very unfair--such as where the party has no real ability to bargain about the terms--the agreement may be procedurally unconscionable and unenforceable. This is especially likely where the agreement is an adhesion contract, and where there are also elements of substantive unconscionability (unfairness in the actual terms of the agreement).

In this case, Many signed a property insurance agreement that was a long, complex, pre-printed form agreement with small print which had been completely drafted by World Wide--an adhesion contract. In addition, Many was unable to read well. He was persuaded to sign the agreement by the experienced sales person Yos. She convinced him that this policy was what he needed to protect him from flood damage--even though it did not cover flood damage caused directly by rain!

In this situation, many courts would probably not enforce the agreement as it is written. It has many elements of procedural unconscionability. They include the presence of the adhesion contract, Yos' misleading behavior and persuasiveness, and Many's inability to read well. The agreement may be substantively unconscionable as well, if the amount of coverage it actually provides is worth much less than $10 per month--which seems likely since flooding caused directly by rain is the most likely way Many's house might be damaged. It does subject Many to "unfair surprise," since he would probably never have made the agreement if he knew about the exclusion of coverage. In addition, Many might be able to show that the agreement is voidable because of unilateral mistake, misrepresentation, or even undue influence, as explained in Sections 7.3, 7.4, and 7.6, above. But even if he could not prove those claims, this agreement probably cannot be enforced as it is written because it is unconscionable.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3i contains further discussion of how courts respond to adhesion contracts.

(2) Substantive Unconscionability Is Extreme Unfairness in the Actual Terms of an Agreement

Substantive unconscionability is extreme unfairness in the actual terms of an agreement. It occurs where what the agreement actually says is so

unfair to one party, based on all the circumstances, that to enforce the agreement would shock the conscience of the court. So substantive unconscionability does not depend on unfairness in the way the agreement was formed. Of course, as noted above, some authorities believe that courts are unlikely to refuse to enforce an agreement unless some elements of both types of unconscionability are present.

There are several types of agreements courts may refuse to enforce because of substantive unconscionability. Two important types are discussed below: (1) agreements that charge excessive prices; and (2) agreements that interfere with remedies.

(1) Excessive Prices -- As discussed earlier, courts are generally very reluctant to interfere with the bargain of the parties. The general rule is that they will not refuse to enforce an agreement merely because one party claims that terms such as the price are "unfair."

However, some courts may refuse to enforce agreements where the price in the agreement is so unfair that it is shocking, and other elements of unconscionability are present. It appears that this rule is applied mostly to protect individual consumers. One situation in which courts may use it is where the consumer buys on credit--paying in a series of installments over a certain length of time--and the consumer is not really aware of the total price that he has agreed to pay. Such consumers may also have no way to get certain products except on credit terms that are not favorable to them. Usually, this rule about excessive prices seems to require that the total price be at least two or more times the market value of the subject matter in order for the agreement to be unconscionable. Finally, it is less likely that courts would refuse to enforce agreements on this basis unless some elements of procedural unconscionability were also present.

*** ***CASE STUDY 173***

FACTS Huot sells large containers of drinking water to various houses and businesses. His special service includes delivering the containers to people's homes, and taking them away when they are empty.

One day, Huot comes to Than's house and says he would like to supply Than with clean water. Than tells Huot that he does not have much money, but that his family often gets sick from bad water. Than is very excited when Huot tells him that he can get a supply of clean drinking water for only 2,000 riels each week. Huot mentions briefly that this will actually mean Than will get two bottles per week, and that there is also a "standard service charge" of 3,000 riels per week. But Huot stresses many times, in a very aggressive way, that the price is only 2,000 riels per week. Huot tells Than this is a very good price, and Than has never bought bottled water before, so he believes Huot. Huot doubts that Than will be able to pay this money for very long. But Huot decides he will try to get as much money as he can under the agreement,

then threaten to sue Than if Than fails to pay, in order to get every last bit of Than's money. Than and Huot agree that Huot will supply water to Than on this basis for 3 months.

Later, Than's wife tells him that the market price for the delivery of these bottles of water is only 700 riels each--less than one third of the amount he has agreed to pay. Than tells Huot he will not obey the agreement. Huot threatens to sue Than.

QUESTION OF LAW Can Huot enforce this agreement?

DECISION Probably not. This agreement is probably unconscionable because the price is excessive, and because of other factors.

Agreements may be unenforceable where they are substantively unconscionable because the price is extremely unfair, and where other elements of unconscionability are present. In this case, Huot made an agreement to sell Than water at a price of 2,000 riels for two large bottles per week, plus a 3,000 riels per week "service charge." This is actually 2,500 riels per bottle. But the market value of the delivery of such a bottle is about 700 riels. The price Huot charged is probably so unfair--since it is far more than three times the market price--that it is substantively unconscionable.

In addition, Huot used an aggressive sales technique, stressing the 2,000 riels price, and barely mentioned how many bottles Than would actually get and the 3,000 riels per week extra charge. Finally, Huot knew that Than was poor and desperate to improve his family's health, that he was not familiar with the bottled water market, and that he would have difficulty paying for the water for long. These are elements of procedural unconscionability.

All the above factors together mean that the agreement is probably unconscionable. So Huot probably cannot enforce it.

(2) Interference with Legal Remedies -- Sometimes agreements contain provisions that try to limit the rights of one party to the legal remedies which may be available if there is a problem in the performance of the agreement. This kind of provision can result in unconscionability if the "remedy meddling" is extremely unfair, based on the commercial setting and the other circumstances of the agreement. If such provisions are unconscionable, they are not enforceable.

Sometimes agreements may try to limit warranties that protect buyers of goods, services, or property. Warranties are complex, and they cannot be fully explained here. However, they are basically promises by a seller that his goods, services or property meet certain standards of quality, fitness, or safety. Warranties may be contained in a contract between the parties. Or they may actually be imposed by the law--even if the contract itself says nothing

about them! For example, under statutes like the Uniform Commercial Code in the United States, all sale of goods contracts automatically contain a "warranty of merchantability"--whether the contract actually says so or not. This warranty basically means the seller promises (or warrants) that the goods are of a quality and fitness sufficient to satisfy the reasonable expectations of the buyer. And there are many other kinds of warranties some jurisdictions say are automatically included in certain types of agreements, such as the "warranty of habitability" in residential lease contracts.

The reason many jurisdictions have these statutes is to protect parties--especially individual consumers--from suffering harm, and possibly losing important rights, because they lack bargaining power. So courts look very carefully at contract provisions that try to limit these warranties. Such provisions are likely to be considered unconscionable if they are extremely unfair. For example, some jurisdictions say parties may be able to limit another party's ability to get "commercial" compensation (such as for damage to property) for breach of a warranty, but that limits on compensation for harm to persons are probably unconscionable. Otherwise--if parties with great bargaining power could completely escape warranties simply by writing a short clause into a contract--there would be little reason to have the statutes about the warranties.

Another way parties sometimes try to interfere with remedies occurs when parties use exculpatory clauses in agreements to relieve themselves from liability for future harm. This was already discussed in detail in Chapter 5 ("Legality"), Section 5.4g. As explained in Chapter 5, exculpatory clauses may be unenforceable because they violate public policy. In many jurisdictions, exculpatory clauses are not enforceable as to intentional or reckless torts. And they are enforceable as to negligent torts only if it would not violate public policy. In fact, many jurisdictions will not enforce such clauses as to negligent torts where one party has much greater bargaining power and the other party has little ability to bargain about the clause, on the basis that it violates public policy. Other courts may say such clauses are unenforceable because they are unconscionable remedy meddling. In any case, most courts look closely at such clauses. If they are extremely unfair in a particular situation, the courts are unlikely to enforce them.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.4g, and Chapter 8 ("Interpretation of Contracts"), Section 8.3i contain further discussion of exculpatory clauses.

*** ***CASE STUDY 174***

FACTS Vandy owns a company that sells large canisters of natural gas that people use to cook food. She tells Borin, a small restaurant owner, that she will supply his restaurant with a certain amount of gas, at a certain price, for one year. Borin likes her offer. Together the parties sign the standard, pre-printed form agreement that Vandy's company usually uses.

A few months later, one of the natural gas canisters explodes in Borin's restaurant, seriously injuring Borin and causing damage to the restaurant. Borin is very angry. But when he looks at the agreement he signed with Vandy, he sees that there is a clause that says he waives the right to bring a lawsuit against Vandy's company for any harm caused by her gas canisters, or for breach of any warranties related to the gas canisters. He had never read this clause, which was in small print on the fourth page of the form agreement. Vandy tells him this means she has no responsibility to Borin at all for the damage he has suffered.

QUESTION OF LAW Can Vandy enforce this part of the agreement?

DECISION Probably not. This part of the agreement is probably unconscionable because it tries to limit the legal remedies normally available to Borin in a very unfair way.

Agreements are unenforceable where they are substantively unconscionable because they try to limit the remedies of one of the parties in a very unfair way, especially where other elements of unconscionability are present. In this case, a clause in the agreement between Vandy and Borin said that Borin had no right to bring a lawsuit against Vandy for any harm caused by her gas canisters, and that he waived the right to enforce any warranties related to the canisters. This kind of limiting of remedies is probably unconscionable. In addition, elements of procedural unconscionability are present: Borin had little ability to bargain about the clause, which was located in a place that was hard to find, in a standard, pre-printed form agreement. Under these circumstances, the clause limiting Borin's remedies is probably not enforceable to prevent a lawsuit against Vandy on the basis of negligence, or breach of the warranty of merchantability, at least as to Borin's personal injuries.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains a more complete discussion of remedies available to parties when there are disputes about the performance of contracts.

7.7c Unconscionable Parts of Agreements Are Generally Unenforceable, but Severance or Reformation May Be Possible in Certain Cases

Courts usually say that unconscionable parts of agreements are "unenforceable." This generally appears to mean that such parts of agreements are void and unenforceable by anyone, although this is not completely clear. Of course, it is unlikely that a party who was the victim of such a provision would wish to enforce it as it was written.

When parts of agreements are unconscionable, courts have several options. First, courts may simply refuse to enforce the agreement at all. This is likely where the unconscionable part of the agreement cannot be severed or

reformed. That would be the case in situations such as the one in Case Study 173, where the whole water supply agreement was affected by the unconscionability in the price--obviously, a price in such an agreement is too important to be severed.

However, if it is possible to sever the unconscionable part of the agreement, courts may do that and enforce the rest of the agreement. For example, a court might simply sever an unconscionable remedy meddling provision, and enforce the rest of the agreement. Severability of illegal parts of agreements was discussed in Chapter 5 ("Legality"), Section 5.5b, and the rules are similar here.

In addition, as with usurious agreements and some agreements resulting from mistake, courts may also choose to reform the agreement by changing the unconscionable part. That could occur in a situation like Case Study 174, where a court might not enforce the gas contract provision limiting Borin's remedies as to certain claims, but might enforce it as to other claims. Of course, courts are often reluctant to reform agreements, because it really is a way of "rewriting" the parties' agreement. Unlike the situation with usurious loan agreements, where there is a statute to tell the court what the maximum "fair" interest rate is, there may be no reliable guideline to tell courts what a "fair" price or other provision in an unconscionable agreement is.

These options are similar to the way courts may deal with usurious loan agreements. In that situation, courts may either not enforce the agreement at all; enforce the agreement but without the illegal part (where courts enforce usurious agreements with no interest at all); or enforce the agreement in a "legal" form (where courts enforce a usurious agreement at the legal rate).

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.5b discusses severability and the effect of usurious agreements; and Chapter 10 ("Remedies"), Section 10.7c discusses severance and reformation.

7.8 Where Promissory Estoppel Applies, a Promise May Be Enforceable If a Party Justifiably Relied on It, Even Though There Is No Valid Agreement

Sections 7.3-7.7 discuss contract formation problems that may cause an agreement to be invalid even though it appears to have the basic elements of a valid contract. This Section explains a special situation where there is no valid contract, but common law courts enforce one party's promise because another party justifiably relied on the promise, and injustice will result if the promise is not enforced. That is the formation "problem" that may lead courts to apply the doctrine of promissory estoppel.

7.8a Introduction to Promissory Estoppel (Detrimental Reliance)

Promissory estoppel, which is also called detrimental reliance, is a doctrine which the courts of some common law jurisdictions use to avoid injustice where one party justifiably relies on the promise of another party, even though there is no valid contract. The doctrine is used when one (or more) of the elements of a valid contract is missing--such as where the parties have not met the requirements of real agreement, consideration, or formality--but for unusual reasons, the only way to avoid injustice is to enforce a promise one party made. The power of courts to use promissory estoppel is very limited, because promissory estoppel is a kind of exception to regular contract law rules. It appears that civil law jurisdictions do not use the doctrine of promissory estoppel. But they may have other ways to protect parties in these situations, as discussed in Section 7.9 below.

*** **DEFINITION: Promissory estoppel (detrimental reliance)** is a doctrine some common law jurisdictions use to avoid injustice by enforcing promises on which parties justifiably rely, even though there is no valid contract.

Promissory estoppel was already discussed to some extent in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, which explained how it may be used to make the promises of an offeror enforceable in a bidding situation, even if there is no valid agreement. In addition, Chapter 3 ("Consideration"), Section 3.8g briefly explained that promissory estoppel was an exception to the common law requirement of consideration. This Section will explain promissory estoppel in more detail.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e discusses how some courts use promissory estoppel to enforce promises offerors make where offerees have justifiably relied; and Chapter 3 ("Consideration"), Section 3.8g discusses how promissory estoppel might be used to enforce promises even where there is no consideration.

In many jurisdictions, promissory estoppel requires that the following five elements be present:

(1) there must be a real case;

(2) there must be a promise by one party;

(3) another party must actually rely on that promise;

(4) that party's reliance must be justified;

AND (5) the party who relied on the promise will suffer unjust loss or damage if the promise is not enforced.

Because it is very difficult to meet all five of these requirements, the power of the courts to use promissory estoppel is very limited. Courts cannot use promissory estoppel to enforce every promise that is made outside of

a valid contract. The reason is that the law wants parties to meet all the requirements of valid contracts if they want promises to be enforced.

When courts do enforce promises on the basis of promissory estoppel, they enforce them only to the extent that justice requires. This means that a party using promissory estoppel to enforce a promise will probably not have the option to get all the different kinds of legal remedies that are normally available with valid contracts. In fact, where promissory estoppel applies, damages are usually limited to reliance damages, which basically try to place a party in the position he occupied before a contract or promise was made. Other remedies are possible, but reliance is the most likely. This will be discussed in more detail in Section 7.8c, below.

Although courts use promissory estoppel rarely, there are certain types of situations where it seems to be used more than other situations. The following are brief descriptions of some of these important situations.

(1) Reliance on Promises before Acceptance -- Courts sometimes use promissory estoppel where a party justifiably relies on a promise made before a valid offer and acceptance exist. This can happen in various ways. Sometimes parties may justifiably rely on promises found in valid offers before acceptance occurs. One example of this kind of situation is the one described in Case Study 55, in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e. In that case, the court used promissory estoppel to protect a general contractor (Prosperity) who relied on a bid from a sub-contractor (Central Electric) in order to make its own bid for a construction project. In this way, promissory estoppel protects the important process of commercial bidding.

In addition, parties may rely on statements made by a party where there is not even a real offer yet, although that is rare. For example, it is possible for a party to justifiably rely on a promise by one party to a negotiation that the parties will eventually reach agreement, even though no contract can generally result from such a promise.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e explains how promissory estoppel may prevent an offeror from revoking his offer.

(2) Oral Promises That the Law Requires to Be Written -- Sometimes a party makes an oral promise that the law normally requires to be written in order to form a valid contract. Although such promises cannot generally be enforced, they may be enforceable if all the elements of promissory estoppel are met. For example, if a party justifiably relies on an oral land transfer agreement, promissory estoppel may be used to make the promise enforceable. And as explained in Chapter 6 ("Formality"), Section 6.3b, some jurisdictions say that an oral land transfer agreement may actually become enforceable if one party has partly performed it, and changed her position in reliance on

the agreement. This is similar to promissory estoppel, though not the same, because of the different elements required.

There may also be situations where it is difficult, as a practical matter, to create a writing, even though the law normally requires one. For example, civil law jurisdictions with laws like those in France do not appear to require writings when it is "materially or morally impossible" to create them, such as might occur with promises between family members, or in certain markets. In common law jurisdictions, promissory estoppel could operate to make such promises enforceable even though the writing requirement has not been met, as long as justifiable reliance exists.

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality") explains some of the important types of agreements that many jurisdictions require to be written, including agreements for the transfer of land (Section 6.3b), and also discusses the civil law perspective on formality (Section 6.9).

(3) Promises Not Supported by Consideration -- Sometimes parties make promises that are not normally enforceable in common law jurisdictions because they are not supported by consideration. Consideration was explained in detail in Chapter 3 ("Consideration"). When there is no consideration, there is no valid agreement, but a party's promise might still be enforceable if the requirements of promissory estoppel are met. This was already explained in Chapter 3, Section 3.8g.

One common way this might occur is where one party promises to make a gift. For example, promissory estoppel might be used where one family member promises another to give a gift in return for some past actions, or for some other reason, and the party receiving the promise justifiably relies on it. Promissory estoppel has also been used where a party has justifiably relied on a promise to give land. Case Study 175, below, illustrates both these possibilities.

Some authorities say that charitable donations are another example of a situation where promissory estoppel may apply. However, as discussed in Chapter 3, Section 3.8a, these types of promises do not need consideration to be enforceable, in many common law jurisdictions. This means that such promises--unlike promissory estoppel--do not require reliance to be enforceable. So parties do not really need the doctrine of promissory estoppel to make such promises enforceable, although some have argued that promissory estoppel is the theoretical basis for the exception, since charities may rely on such pledges in making their plans and commitments.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration") explains the general common law requirement of consideration, and some exceptions to that requirement, including charitable donations (Section 3.8a), and promises that meet the requirements of promissory estoppel (Section 3.8g).

*** ***CASE STUDY 175***

FACTS Kosal was the youngest of the four children in his family. Even though Kosal was the youngest, his parents saw that he worked the hardest and was the most trustworthy. So his parents promised that they would leave the family farm and land to him when they died. But though the law required all contracts to transfer a substantial interest in land to be written, Kosal's parents never put their promise to him in writing. They did tell Kosal's three siblings and several neighbors about their decision. And they repeated their promise to Kosal several times in the following years.

In reliance on his parents' promise, Kosal stopped studying at the university, and returned to his parents' farm to work for several years. Kosal's three siblings never did anything to help, and rarely visited their parents. But when the parents died years later, the other brothers came and demanded that the land be divided equally among all four of them. After trying but failing to solve the conflict directly with his brothers, Kosal now asks the court to make a decision.

QUESTION OF LAW Can Kosal enforce his parents' promise to give him the farm after they died?

DECISION Yes. Kosal can enforce the promise because, even though the promise was not written and lacks consideration, Kosal can meet all of the requirements of promissory estoppel.

Even where no valid agreement exists--because of a failure to meet requirements such as formality or consideration--a promise may still be enforceable if the five requirements of promissory estoppel are met: (1) a real case, (2) a promise, (3) actual reliance, (4) justifiable reliance, and (5) injustice if the promise is not enforced.

In this case, Kosal's parents promised to give him the family farm when they died. The law in this jurisdiction requires that land contracts be written, and common law jurisdictions generally require consideration, so this promise might not normally be enforceable.

But Kosal's situation meets the five requirements for promissory estoppel which are noted above. First, Kosal actually asked the court to make a decision in the case, so there is a real case. Second, Kosal's parents made a promise to Kosal. Third, Kosal clearly relied on that promise, since he left university and returned home to work on the farm. Fourth, Kosal's reliance was justifiable: his parents told him, his siblings and many neighbors about what they would do with the farm, and he had no reason to doubt what his parents said. And fifth, injustice would occur if the promise was not enforced, because Kosal gave up many things in reliance on the promise, including his university education, and his right to live and work somewhere else during the years that he helped his parents on the farm.

So in this situation, Kosal can enforce his parents' promise--even though the law requires such promises to be written, and even though common law jurisdictions generally require consideration for agreements to be enforceable. Kosal can probably get the farm that his parents promised him. This remedy, which is called specific performance, is appropriate because other remedies would probably not achieve justice in this special case.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies"), Section 10.7a discusses the remedy of specific performance, and Section 10.8c discusses remedies where courts apply promissory estoppel.

*** ***WHY IS THIS IMPORTANT?*** Why do common law courts occasionally use promissory estoppel to enforce promises, even though there is no valid contract?

In general, promises that fail to meet the basic requirements for a valid contract cannot be enforced in free market jurisdictions. The reasons for this have been discussed throughout this text. Basically, the law creates rules about how parties must create enforceable agreements in order to protect the rights and reasonable expectations of the parties themselves. These rules also give courts reasonable standards for enforcing contract obligations, and help the free market economy function efficiently.

However, in rare situations, one party makes a promise, another person justifiably relies on that promise, and the only way to avoid injustice is to enforce the promise--even though there is no valid contract. In this way, the law tries to avoid the harsh results that might occur in some situations if the regular rules about valid contracts applied. In a way, this is an admission that the regular rules about valid contracts do not work in every situation! The law wants to be flexible enough to achieve justice when its regular rules cannot do so.

However, the rules about promissory estoppel could be very dangerous if they were not used carefully, and only in limited situations. The reason is that if courts used promissory estoppel too often, parties might no longer bother to meet all the requirements of valid contracts, and much of contract law could collapse! So courts are very careful to use promissory estoppel only in exceptional cases: when all five of the requirements described above are met.

Authorities do not seem to agree about the basis of the doctrine of promissory estoppel. Some basically say that promissory estoppel developed as a substitute for consideration, since many of the early uses of the doctrine were to enforce promises that lacked consideration. However, modern courts also apply promissory estoppel in other situations, so it might be viewed as supplying whatever else would be required to create a valid contract, such as a writing. Other authorities say much of promissory estoppel is actually based on tort law, since it is really a way of holding a party liable for damage caused

when another party is damaged through reasonable and foreseeable reliance on a promise the first party made.

7.8b The Elements of Promissory Estoppel

As explained above, it is essential that a party meet all five of the requirements of promissory estoppel if that party wants to enforce a promise on that basis. The five essential elements of promissory estoppel are more fully explained below.

(1) There Must Be a Real Case -- As noted in previous Chapters, courts in free market jurisdictions may generally use their powers only in "real cases." This rule restricts the decision-making power of courts and arbitrators to situations in which there are genuine disputes. In practice, this basically means that such decision-makers can generally make decisions only in cases which are brought to the court or arbitrator by someone involved in the dispute. Of course, this also means that courts generally cannot make a decision in a dispute if no one involved in that dispute brings it to court.

So even if it seems that it would be helpful for a court to apply promissory estoppel in a particular situation, the court can do that only if one of the parties involved in the situation formally asks the court to do so. For example, in Case Study 175, the court could not have made a decision in the dispute between Kosal and his siblings if none of the parties involved had requested that.

(2) There Must Be a Promise by One Party -- Before the court can use promissory estoppel, the court must be satisfied that a promise was made. Most kinds of promises can be the basis for promissory estoppel, including a promise to do something, as in Case Studies 55 and 175 above, or a promise to not do something. The promise can be oral, like the promise of Kosal's parents in Case Study 175, or written, like the bid from Central Electric in Case Study 55. And the promise could be implied. Of course, certain kinds of promises cannot be enforced under any circumstances, such as promises to perform illegal acts.

(3) Another Party Must Actually Rely on the Promise -- Reliance is a very important element of promissory estoppel. In fact, one party's reliance on a promise is the basic reason the law considers enforcing the promise in such situations--even though there is no valid contract! But that party must convince the court that he really did rely on the promise. To do that, the party must show that he would not have done something except for the promise--that the promise caused him to do something. For example, in Case Study 175, Kosal could show the court that right after his parents made their promise to him, he stopped studying at the university and moved back home to take care of them and the farm. And in Case Study 55, Prosperity Construction could show its reliance on Central Electric's promise (bid) by showing the court how it had submitted its own bid, which included Central's bid.

(4) That Party's Reliance Must Be Justified -- Whether reliance was justified is probably the most important--and often the most difficult--element of promissory estoppel. Not all reliance allows a court to use promissory estoppel. On the contrary, promissory estoppel protects only parties whose reliance was justified under all the circumstances.

One way to try to see if reliance was justified, according to some authorities, is to ask whether the way the party relied was reasonably foreseeable by the party who made the promise. In other words, some courts ask whether a reasonable promisor would have foreseen how the other party would rely on the promise. For example, in Case Study 175 above, Kosal's reliance was reasonable--his parents could have foreseen it--because of several facts. The promise on which Kosal relied came from his parents (the owners of the farm); his parents made the promise in public; and they repeated it several times during the years before they died. In Case Study 55, Prosperity's reliance was reasonable--Central could have foreseen it--because the only reason general contractors like Prosperity advertise for bids is that they want to be able to choose and rely on the best sub-contractor bids possible. This "reasonably foreseeable" requirement is actually similar to one of the requirements for tort liability in many jurisdictions.

Of course, this means that if a party's reliance on a promise was not justifiable under the particular circumstances in a case, then promissory estoppel will not make the promise enforceable. In such cases, it does not matter that a party really did make a promise, or that the other party really did rely on that promise, or even that the other party will suffer damage if the court does not enforce the promise. Justifiable reliance is the key to promissory estoppel.

(5) The Party Who Relied Must Suffer an Unjust Loss or Damage If the Promise Is Not Enforced -- As discussed above, common law jurisdictions developed the doctrine of promissory estoppel in order to try to reduce injustice in cases where one party reasonably relied on a promise by another party, even though they had no valid contract. The law recognizes that when a party makes a promise, and another party relies on that promise in a reasonable way, then it might be unjust for a court to refuse to enforce that promise.

In particular, injustice will generally occur if a party will suffer real loss or damage as a result of his justifiable reliance on another party's promise, unless the court enforces the promise in some way. For example, in Case Study 175, Kosal gave up his study at the university and his right to live somewhere other than his parents' farm. He changed his entire life in reliance on the promise. And in Case Study 55, Prosperity would lose at least the $20,000 difference between Central's bid and the cost to have another electrical firm do the work, unless the court ordered Central to obey its promise to do all the electrical work for $50,000, or provide another remedy. So in both these cases, the parties who justifiably relied on the promise would suffer real harm if the promise was not enforced. Of course,

whether such harm will be "unjust" relates to whether the party's reliance was justified. So if a party justifiably relied on a promise, and the party will suffer real harm if the promise is not enforced, then that harm is probably unjust.

In fact, probably the most difficult questions for courts to answer, when parties ask to have promises enforced on the basis of promissory estoppel, are the related questions of whether the fourth and fifth elements above are satisfied: whether reliance was justified, and whether unjust harm will result. Compare the following two Case Studies.

*** ***CASE STUDY 176***

FACTS Ken has a bad job in Phnom Penh. His old friend Margo runs a school in Battambang, and she talks to him about a much better job there. She says to him, "I think you would be a lot happier here. I'll give you a job working for me. We pay a good salary. Why don't you settle your affairs in Phnom Penh and come up here at the beginning of next month? We'll sign a contract then." Ken agrees, and goes out to celebrate.

Ken quits his job in Phnom Penh, sells his house, and moves to Battambang. After he arrives, he goes to see Margo about the job. She says, "Sorry, there is no job." After failing to persuade Margo to at least pay him for his losses, Ken asks the court for help.

QUESTION OF LAW Can Ken enforce Margo's promise to give him a job in Battambang?

DECISION Perhaps, to the extent necessary to avoid injustice. Ken may be able to enforce Margo's promise, even though there is no valid contract, because he may be able to meet all of the requirements of promissory estoppel.

Even where no valid agreement exists--because of a failure to meet requirements such as a definite offer and acceptance--a promise may still be enforceable if the five requirements of promissory estoppel are met: (1) a real case; (2) a promise; (3) actual reliance; (4) justifiable reliance; and (5) injustice if the promise is not enforced.

In this case, Margo promised to give Ken a job in Battambang. But her promise was probably not definite enough to form a valid contract. There was no salary term, starting date, or even a job description.

However, a court might enforce her promise to Ken to the extent needed to prevent injustice, using promissory estoppel. This is because the five elements of promissory estoppel may be met. First, there is a real case, because Ken has asked the court for help. Second, Margo did promise to give Ken a job, although the promise was not definite enough to be a valid offer. Third, Ken clearly relied on the promise by quitting his job in Phnom Penh, selling his house, and moving to Battambang. Fourth, his reliance was

probably reasonable, even though it is rare that reliance on such an indefinite promise will be reasonable. In this case, the promise was from an old friend who Ken knew ran a school in Battambang. Ken had good reason to believe that Margo had a job for him, and that she had the power to give him one, since she ran the school. In addition, the way Ken relied was reasonable: he quit his Phnom Penh job, sold his house, and moved to Battambang. Obviously, most people would have to do these things in order to work in Battambang. And Margo should have foreseen that Ken would rely in this way--she knew he was desperate for a new job. And in fact, Margo actually told him to settle his affairs and come to Battambang! Finally, injustice will likely result if the promise is not enforced, since Ken's reliance was probably justified, and since he now has no job and no house, and he has spent money to travel to Battambang.

However, it is important to note that a court would probably not award Ken any of the money he might have earned working for Margo. There is no way the court could calculate damages like that, with such an indefinite promise. And the court would not order Margo to actually give Ken a job, because she really did not make an offer the court could enforce that way. Instead, the court would award the damages necessary to avoid injustice, which in this case would likely be reliance damages. As explained in Section 7.8c below, reliance damages would be the amount of money Ken lost by relying on Margo's promise--by quitting his job in Phnom Penh, selling his house, and moving to Battambang. This amount could be hard to determine exactly, but the court would try to do so in a fair way.

*** ***CASE STUDY 177***

FACTS Suppose the facts of Case Study 176 happened in a somewhat different way. In this new scenario, the job Margo talked about was only five kilometers from Ken's house in Phnom Penh, and Ken did not quit his current job, sell his house or move. In talking about the job, Margo said basically the same things as in Case Study 176, except that the job was in Phnom Penh.

However, after this first conversation with Margo, Ken went out and purchased an expensive new car on credit in order to travel to his new job. When Ken came to see Margo about the job, Margo said there was no job. Ken complained to the court, saying that he would never have bought the car if not for the new job he thought he had, and that now he had little use for the car.

QUESTION OF LAW Can Ken enforce Margo's promise?

DECISION No. In these circumstances, Ken's purchase of an expensive car to get to the job is not reasonable reliance.

Even where no valid agreement exists--because of a failure to meet requirements such as a definite offer and acceptance--a promise may still be enforceable if the five requirements of promissory estoppel are met.

In this case, Ken relied on Margo's promise of a new job in Phnom Penh, and bought a car to get to work.

As in Case Study 176, Ken could probably meet the first three requirements of promissory estoppel, since there was a real case, a promise, and actual reliance (his purchase of the car). However, Ken's reliance in buying an expensive new car was not reasonable. Ken had other, less expensive ways to get to work, such as a moto or bicycle. At the least, he should probably have waited till he talked to Margo again before he bought anything, since her school was so close to his home. There was no way Margo could have reasonably foreseen this kind of reliance. Likewise, although Ken may suffer a loss--if he has to sell the car for less than he paid--he has not suffered an unjust loss, because he never should have bought the car in the first place. For these reasons, Ken cannot enforce Margo's promise.

The situation described in Case Studies 176 and 177, where a court may enforce a promise even though it was not definite enough to be an offer, is rare. This is because, in most situations, parties like Ken have no right to rely on promises that are not definite enough to be offers--and so it is unusual that their reliance will be reasonable. And of course, in common law jurisdictions, offers can generally be revoked any time before acceptance.

There have also been cases in a few jurisdictions where parties have actually made a valid agreement about an "at-will" job--which basically means the employer or employee can terminate the relationship any time, for any reason that does not violate public policy--but the employer has terminated the relationship before the employee even has a chance to start the job! In that situation, some courts have used promissory estoppel to give the employee compensation for reliance expenses, such as quitting an old job or moving to a different city, as long as the reliance was reasonable. However, this situation--where there is a valid employment contract, but either party can terminate it any time--appears to be more a problem of contract performance and remedies, which will be discussed in later Chapters of this text.

******* ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties") and Chapter 10 ("Remedies") discuss performance of contracts and what remedies may be available in different situations.

People sometimes confuse promissory estoppel with quasi-contract. Although both promissory estoppel and quasi-contract were developed to try to do justice in certain situations where the parties lack a valid contract, the two doctrines are different. Probably the biggest difference is that promissory estoppel aims to prevent unjust loss caused by justifiable reliance, and does not require unjust enrichment. But the whole purpose of quasi-contract is to prevent unjust enrichment. In addition, promissory estoppel always starts with a promise from one party, and quasi-contract may not.

Of course, there are some situations where both promissory estoppel and quasi-contract may apply. This might occur where a party suffers unjust loss because of justifiable reliance on a promise and provides unjust enrichment to another party. For example, where there is an offer for a unilateral contract, and the offeror tries to revoke after the offeree has partly performed, injustice would result if courts applied the usual common law rule that offerors can revoke any time before acceptance. As discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4d, most courts in this situation say that the offeror cannot revoke for a reasonable time. For example, in Case Study 54, Prasith was not permitted to revoke his unilateral contract offer to Someth to plow a field. Even if a court did allow Prasith to revoke, Prasith would be required to pay Someth the reasonable value of the plowing he had completed, under the doctrine of quasi-contract. But promissory estoppel might apply here also! Someth could argue that he justifiably relied on Prasith's promise to pay him for the plowing, and that he will suffer unjust loss if the promise is not enforced. So both quasi-contract and promissory estoppel might apply here--because it appears there was both unjust enrichment and unjust loss caused by justifiable reliance.

This relationship between promissory estoppel and quasi-contract is similar to the relationship between undue influence and unconscionability, doctrines which are different but may overlap in certain cases. That was discussed in Section 7.7, above.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4d discusses how courts respond when one party partly performs in response to a unilateral contract offer.

The following chart compares promissory estoppel and quasi-contract.



Illustration: Comparison: Promissory Estoppel and Quasi-Contract

	PROMISSORY ESTOPPEL	QUASI-CONTRACT
1. What is the main purpose?	Prevent unjust loss caused by justifiable reliance.	Prevent unjust enrichment.
2. What happened?	One party made a promise on which the other party justifiably relied.	One party provided a benefit to another, but the first party cannot enforce a contract.
3. What does the court do?	Enforces the promise to the extent that justice requires, whether the promisor received any benefit or not.	Imposes contract obligations on a party, usually by requiring that party to pay the reasonable value of the benefit he received.
4. Key Differences	(a) Designed to fight unjust loss due to justifiable reliance. (b) Based on a promise by one party.	(a) Designed to fight unjust enrichment. (b) May apply where there is no promise.

******* ***ADDITIONAL REFERENCE*:** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains a more complete discussion of quasi-contract.

7.8c The Effects of Promissory Estoppel: the Promise Is Enforceable to the Extent Justice Requires

Where promissory estoppel applies, courts enforce the promise only to the extent that justice requires. That means that the party seeking the court's help may not be able to recover as much as if the promise was part of a valid contract.

It appears that, when courts apply promissory estoppel, they most often order reliance damages as a remedy. Reliance damages will be discussed in much more detail in Chapter 10 ("Remedies"), but basically they try to place the party in the position he occupied before the promise was made. For example, in Case Study 176, the court would probably award Ken reliance damages. That would likely mean the amount of money he lost in quitting his job, selling his house, and moving to Battambang. Specifically, this would probably be at least the salary he would lose until he could (using reasonable efforts) find a new job, any money he lost in selling his house, and the cost of his trip to Battambang. The idea would be to put him in the position he would have occupied if Margo's promise had never been made. The reason reliance damages are so often given in this situation appears to be that compensating parties for justifiable reliance is the main reason for promissory estoppel. And in most cases, giving such parties the amount they lost by relying is the best way to achieve what "justice requires."

It seems unusual for courts to award more than reliance damages in promissory estoppel cases, but it is possible. In a few cases, courts may choose to award expectation damages, which basically means trying to put the injured party in the position he expected to be in if the promise or contract had been performed. Courts might use this type of remedy where reliance damages would not really achieve justice.

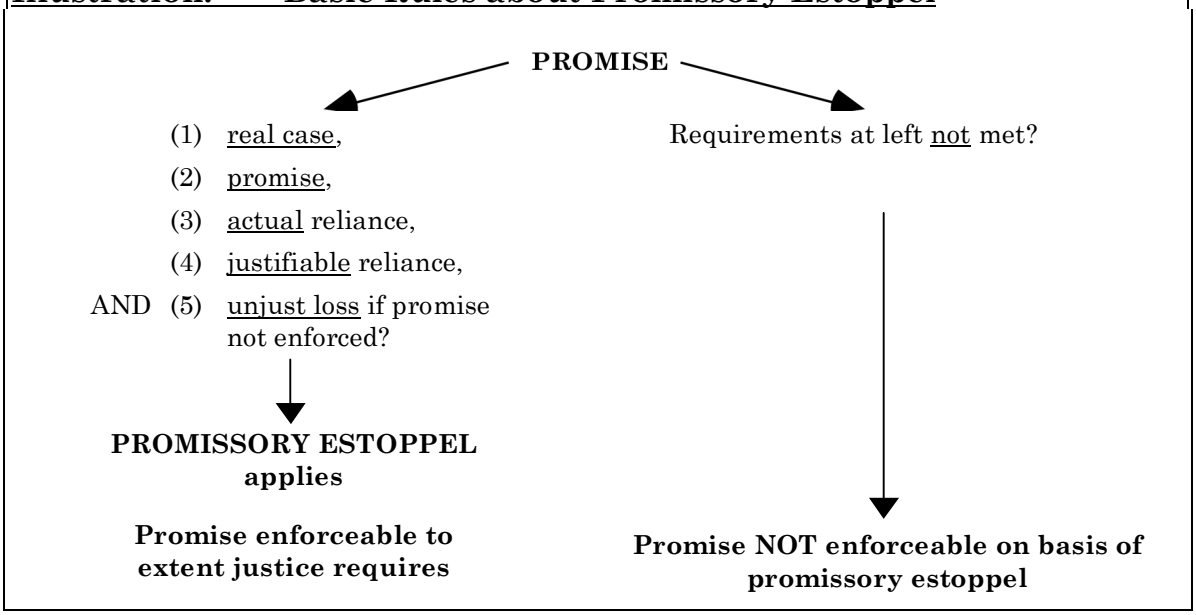
Or in rare cases, courts may order specific performance, which means actually ordering the party who made the promise to perform it. For example, in Case Study 175, it would probably be impossible for a court to put Kosal in the position he would have occupied if the promise had never been made. This is because it would probably be impossible to calculate what Kosal lost by relying--to determine how Kosal's position would be different if he had never left university and come home to the farm years before. And expectation damages might not really put Kosal in the position he expected to be in. That is because he expected to own the farm his parents promised. Common law courts believe land is unique, and that money would not really put him in this position. In that situation, a court might decide to simply enforce the promise specifically--giving the farm to Kosal. Specific performance will be discussed further in Chapter 10 ("Remedies").

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies"), Section 10.2 discusses expectation damages, Section 10.3 discusses reliance damages, Section 10.7a discusses specific performance, and Section 10.8c discusses remedies where courts apply promissory estoppel.

7.8d Summary of Some Basic Rules about Promissory Estoppel

The following chart illustrates some basic rules about promissory estoppel.

Illustration: Basic Rules about Promissory Estoppel



7.9 The Formation Problems Discussed in This Chapter in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the current Cambodian Contract Law (Decree #38D (1988)) and the civil law tradition to the contract formation problems discussed in this Chapter seem generally compatible with the approach discussed above. However, promissory estoppel does not appear to exist in the Cambodian and civil law traditions. And Article 12 of Decree #38D appears to provide courts with unusually broad discretion to allow parties to rescind because of a difference in consideration between the parties to the contract.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) contains provisions relevant to the contract formation problems discussed in this Chapter. These provisions seem basically compatible with the approach to those problems discussed in this Chapter, with the exception of promissory estoppel, and the broad discretion which Article 12 appears to give to courts. Some of the relevant provisions are discussed below.

Basic Provisions

Article 1 of Decree #38D basically defines a contract as a "freewill" agreement to create or affect obligations relevant to the parties. Article 3 states that every contract is valid provided that (among other things) it "arises out of a real and free agreement." Article 6 provides that contracts which do not result from a real and free agreement are voidable. Article 7 states that agreements resulting from mistake, duress or fraud are not real agreements.

Article 13 provides that parties who wish to avoid agreements on the basis of mistake, duress or fraud must prove the matter. Article 19 states that contracts can be avoided on one of the above grounds by the "aggrieved party" or any person with a "lawful interest" in the claim. Article 19 also explains the procedure for the aggrieved or interested party to notify the other party about such a claim.

These provisions seem basically consistent with the approach discussed in this Chapter with regard to agreements that are not real and free. It is not clear whether agreements resulting from mistake or misrepresentation can be void, as they can when the problem is serious enough under the approach discussed in this Chapter. It may be that mistakes about the existence of the subject matter or the meaning of material terms would create void agreements under Article 5, which states that contracts whose "subject matter is impossible to perform" are void. It may also be that mistakes resulting in attempted acceptances by parties who are not intended offerees simply create no agreements at all under Decree #38D.

Mistake

Agreements resulting from mistake are voidable under Articles 6 and 7. Article 8 provides that parties can avoid agreements on this basis if the mistake is about the "substance of the object which is the subject matter of the contract." Article 8 further states that mistake as to a "person" is not grounds for avoiding a contract on this basis except where the "identity of the person is the basis of the contract."

These provisions seem basically consistent with the approach discussed in this Chapter, with a few potential exceptions. Article 8 appears to limit the grounds for claiming mistake to situations where the mistake is about the subject matter of the agreement, or about the identity of a person and the identity of this person is the "basis" of the contract. If these are the only grounds for avoiding a contract based on mistake, then this claim is somewhat more limited under Decree #38D than under the approach discussed in this Chapter. In addition, it is not clear whether the subject matter claim would apply only to mistakes about the identity or quality of the subject matter, or whether it might also apply to the existence of the subject matter. The "identity" claim appears to mean that a party can avoid where he would not have made the agreement except for the identity of the other party. It is not clear how this might apply to situations where an unintended party tries to accept an offer.

As noted above, it is not clear whether agreements resulting from mistake can be void, as they can under the approach discussed in this Chapter. It may be that mistakes about the existence of the subject matter or the meaning of material terms would create void agreements under Article 5, which states that contracts whose "subject matter is impossible to perform" are void, and that mistakes resulting in acceptances by unintended parties simply create no agreement at all under the law.

Misrepresentation

Agreements resulting from "fraud" are voidable under Articles 6 and 7. Article 10 provides that fraud is a basis to avoid a contract where one party commits "acts of deception, dishonesty, or misrepresentation" without which the other party would not have made the contract.

These provisions seem basically consistent with the approach to misrepresentation we have discussed in this Chapter. It is not clear if "innocent" misrepresentation is covered by the provisions above, since such misrepresentation is not usually "fraud." In addition, as noted above, it is not clear whether agreements resulting from misrepresentation can be void. It may be that agreements resulting from what this text has called misrepresentation in the formation are simply not agreements at all under this law.

Duress

Agreements resulting from duress are voidable under Articles 6 and 7. Article 9 provides that parties can avoid agreements on the basis of duress if the duress is in the form of "mental or physical duress" against a party to the contract, a party's spouse, or any ascendants or descendants of a party.

These provisions seem basically consistent with the approach discussed in this Chapter, although "duress" itself is not defined. In addition, under Decree #38D, duress apparently does not apply to threats against siblings of parties, or threats against persons related to parties through siblings.

Undue Influence

Article 11 of Decree #38D provides that if any party to a contract "take[s] advantage of the situation of another party with undue profit," the aggrieved party can rescind the contract. This appears to mean that such an agreement is voidable. Article 11 may be similar to what we have called undue influence in this Chapter, since it appears to involve one party improperly influencing another party who is weaker to make an unfair contract.

Unconscionability

Article 2 of Decree #38D provides that parties to a contract must "collaborate with each other in an atmosphere of good conscience." In addition, Article 11 provides that if any party to a contract "take[s] advantage of the situation of another party with undue profit," the aggrieved party can rescind the contract. Article 12 provides that where "there is a difference between the value of the subject matter offered by one party and the value of the consideration in return, then the aggrieved party can sue to rescind the contract on the ground that he/she never intended the difference to be a gift." These provisions appear to mean that such agreements are voidable.

Articles 11 and 12 may provide a remedy similar to the one described in this Chapter as unconscionability, because both ideas seem to be directed at unfairness in a contract as a basis for a party to rescind. Although Article 11 seems closer to the undue influence situation, there is some overlap between undue influence and unconscionability, as discussed in Section 7.7 above. Article 12 seems somewhat like substantive unconscionability, because both doctrines are directed at unfairness in the actual terms of an agreement. However, unconscionability requires a showing of extreme unfairness, whereas Article 12 does not seem to require any particular degree of unfairness. In addition, under the approach discussed in Section 7.7 above, courts usually also seem to require some elements of procedural unconscionability before they will allow a party to rescind because of unconscionability. Article 12 does not seem to require that. Overall, Article 12 appears to provide courts with more discretion to allow parties to rescind solely because there is some difference in the consideration on each side.

Promissory Estoppel

There do not appear to be any provisions of Decree #38D that correspond to what this Chapter has described as promissory estoppel. However, Article 121 of Decree #38D does state that anyone who causes damage to others through his own fault shall be liable for such damage. This is basically a tort liability statute. It seems possible that Article 121 could be used to recover damages where one party justifiably and foreseeably relies on the promise of another party, and the relying party will suffer harm if the promise is not enforced. As noted above, some authorities believe that a large part of the basis for promissory estoppel is in tort liability.

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to the subjects of this Chapter appears to be generally compatible with the approach discussed above, except that there does not appear to be any civil law equivalent to promissory estoppel. Of course, the exact rules about these topics differ from one jurisdiction to another, so it is important to check the relevant local law.

Civil law jurisdictions appear generally to have approaches to agreements that are defective because of mistake, misrepresentation, or duress that are comparable to the approaches discussed in this Chapter. For example, in France, agreements resulting from mistake, misrepresentation, or duress are voidable. As in common law jurisdictions, not all mistakes are considered serious enough to make an agreement voidable. Where the mistake is not serious enough, the agreement is valid. French law basically says that misrepresentation occurs where an agreement results from one party's false statement, or failure to speak where there is a duty to speak, with an intent to deceive another party. French law also provides that agreements resulting from physical or mental duress are voidable. It appears that, although the law gives courts the option to measure duress by an objective or subjective standard, most courts choose to analyze duress by a subjective standard. This means that, as in common law jurisdictions, the courts basically ask whether the improper threat actually did cause the victim to make an agreement, rather than whether it would have caused a reasonable person to do so.

It appears that many civil law jurisdictions do not apply the specific doctrine of undue influence. However, these jurisdictions may have comparable ways to protect parties in these situations. For example, in France, the doctrine of *lésion* appears to provide that an agreement made by persons in certain protected categories may be voidable where there is an unfair economic imbalance in the agreement. It appears that these categories include unemancipated minors and certain protected classes of adults, such as certain persons who lack full mental competence, and more recently those who are charged exorbitant fees by professionals such as doctors, lawyers, notaries, chartered accountants, bankers, consultants, and private detectives. This focus on unfairness to persons in certain special relationships of trust may be comparable to the common law doctrine of undue influence, although the common law doctrine is not limited to persons in such special relationships.

It appears that many civil law jurisdictions do not apply the specific doctrine of unconscionability. But as with undue influence, some civil law jurisdictions do appear to use doctrines that are comparable to unconscionability to deal with extreme unfairness in contracts.

For example, it appears that there is a German statute regulating the use of what seem to be basically adhesion contracts. This statute limits the ability of merchants to disclaim all liability for defective goods, and generally tries to protect consumers in situations where they may have little bargaining power. It also appears that German courts have used statutory requirements which are related to good faith and fair dealing to prevent unfairness in situations where common law courts might use the doctrine of unconscionability.

The situation in France appears to be similar. In France, the law regulates "abusive clauses" in adhesion contracts, where such clauses are considered to be an "abuse" of economic power by a party in a stronger bargaining position. It appears that, in some circumstances, courts have the power to remove such clauses from adhesion contracts. In addition, parties in certain protected classes may be able to avoid unfair agreements under the doctrine of *lésion*, as discussed above.

Civil law jurisdictions do not appear to have a doctrine comparable to promissory estoppel. However, as noted above in the Cambodian Law Perspective, it may be that parties could try to use tort liability statutes in civil law jurisdictions to achieve some of the same goals that promissory estoppel does. In addition, there may actually be less need for promissory estoppel under certain civil law contract rules. For example, since civil law jurisdictions do not require consideration, there is less need to find a way to enforce promises that lack consideration. In addition, in jurisdictions where offers are generally not revocable for a reasonable time, there may be less need for doctrines like promissory estoppel to prevent the injustice that may occur where offerors revoke after offerees have justifiably relied on offers.

7.10 Questions for Review

CHAPTER 7 -- QUESTIONS FOR REVIEW

1. Are contracts always enforceable as long as they meet the five basic requirements discussed in Chapters 2-6 of this text?

2. What is a mistake?

3. Why are courts reluctant to refuse to enforce agreements on the basis of mistake?

4. When are agreements resulting from bilateral mistakes void?

5. When are agreements resulting from bilateral mistakes voidable?

6. In general, can parties avoid agreements because of mistakes about value?

7. When are agreements resulting from unilateral mistakes void?

8. When are agreements resulting from unilateral mistakes voidable?

9. Give examples of agreements that may be voidable because of unilateral mistakes.

10. What are some potential effects of mistake?

11. What is a misrepresentation?

12. When are agreements resulting from misrepresentation void, and when are they voidable?

13. What are the requirements for misrepresentation in the formation to exist?

14. What are the requirements for misrepresentation in the inducement to exist?

15. What are the types of misrepresentation in the inducement?

16. What is duress and what is the status of agreements resulting from it?

17. Give some examples of duress.

18. What is undue influence and what is the status of agreements resulting from it?

19. What are fiduciary relationships?

20. What is unconscionability?

21. What is procedural unconscionability?

22. What are adhesion contracts?

23. What is substantive unconscionability?

24. Give examples of substantive unconscionability.

25. What is promissory estoppel?

26. What are the requirements for promissory estoppel to apply?

27. Give examples of situations where promissory estoppel might apply.

28. What are the effects of promissory estoppel?

29. Is the Cambodian legal approach to the topics in this Chapter generally compatible with the approach discussed in this Chapter?

30. Is the civil law approach to the topics in this Chapter generally compatible with the approach discussed in this Chapter?

CHAPTER EIGHT

INTERPRETATION OF CONTRACTS

8.1 Introduction

After parties make an agreement, they may have a dispute about what the agreement means. So even if there is an enforceable contract that meets all the formation requirements discussed in Chapters 2-7, there may still be disputes about what rights and duties the contract creates. Of course, it may sometimes be necessary to resolve such disputes in order to determine whether an agreement is enforceable or not. These disputes generally occur where the meaning of some part of the contract is not clear, although there are a few special situations where courts may supply or sever contract terms even where what the contract states is clear.

Parties often ask courts to resolve such disputes by interpreting the contract. This requires the court to actually decide the meaning of the disputed part, or "term." This text will use the word "term" to describe any particular part of the contract whose meaning is disputed by the parties--whether that part is one word long or 100 words long. For example, parties to a sale of goods contract may dispute the meaning of the "delivery term"--a term which may be described in a clause 50 words long. In this text, the "delivery term" means that entire 50-word clause.

Courts interpret agreements when the parties ask them to do so. Sometimes courts must interpret contracts to determine if they are enforceable at all. More often, courts must decide the meaning of enforceable contracts, in order to resolve disputes between the parties. Section 8.2 discusses this.

Because the power to interpret a contract is a great power, free market jurisdictions carefully guide and limit it. Section 8.3 discusses some of the most important of these "guides and limits." Specifically, it explains ten general rules of interpretation that many courts follow in deciding what agreements mean:

(1) courts try to interpret contracts so that they are valid and reasonable, but courts cannot simply interpret contracts any way they wish (Section 8.3a);

(2) many jurisdictions say interpretation should be subjective--based on the actual intentions of the parties--but if that is not possible, then it should be objective--based on what reasonable people generally intend in similar situations (Section 8.3b);

(3) courts consider the whole contract (Section 8.3c);

(4) courts try to avoid inconsistency between terms (Section 8.3d);

(5) when terms in a contract conflict, courts value certain types of terms more highly than other types of terms (Section 8.3e);

(6) courts consider the ordinary meaning that a reasonable person in the parties' situation would understand a disputed term to have (Section 8.3f);

(7) courts consider the main purposes of the parties when they made the contract (Section 8.3g);

(8) courts consider all the surrounding circumstances, particularly the course of performance, prior dealings between the parties, and trade usages (Section 8.3h);

(9) disputed terms are interpreted against the party who drafted the contract, if that is reasonable in the circumstances (Section 8.3i);

and (10) courts in many jurisdictions interpret contracts to contain specific terms that the law requires or allows, if the parties omitted those terms (Section 8.3j).

Courts use various types of evidence to help them decide the meaning of agreements. In general, this can include documents, testimony from the parties or other witnesses, and reference materials. However, the common law "parol evidence rule" limits the use of certain types of evidence. This rule basically says that where a final writing contains contract terms of the parties, a court cannot generally allow evidence of statements made by the parties prior to that writing to contradict or add to the terms of a complete writing, or contradict the terms of an incomplete writing. The types of evidence courts may use to resolve interpretation disputes are discussed in Section 8.4.

Finally, Section 8.5 explains what happens if courts cannot interpret a disputed part of an agreement. When a material term cannot be interpreted, the agreement is probably unenforceable, since it is probably not definite and reasonably clear. But when an immaterial term cannot be interpreted, the agreement may be enforceable without that term, if the court can sever the term.

******* ***WHY IS THIS IMPORTANT?*** Why is the interpretation of contracts such an important power in free market jurisdictions?

The ability of courts to interpret contracts is important for several reasons. One reason is that sometimes parties need the court to tell them what their contracts say! The basic purpose of interpreting a contract is to determine what rights and duties the parties created when they made their contract. Once courts interpret a contract, they know whether to enforce it and how to enforce it. But if there were no fair and efficient methods to interpret contracts, then parties would not be able to rely on their own contracts. In some cases, they would not even be able to understand their own contracts. A court's interpretation of a disputed contract term can also be a helpful guide for the parties to follow in the future.

Another reason contract interpretation is important is that it often helps to resolve or even prevent disputes. A party usually asks a court to help interpret her contract only when she thinks that another party to the contract has violated or will violate the contract. So by providing fair interpretations, courts give parties a way to end or avoid conflict related to their contracts.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4g contains a more concise discussion of the interpretation of contracts.

8.2 Courts Interpret Contracts When the Parties Ask Them to Do So

Courts interpret all kinds of contracts, from small implied contracts to complex, carefully drafted contracts creating international joint ventures. But even where contracts are written, or prepared by lawyers, there are often disputes between the parties about the meaning of the contracts.

When parties bring such disputes to court, the court tries to help them resolve the dispute, by providing a fair and appropriate interpretation. But the court has no power to act in such disputes unless at least one of the parties asks it to do so. And of course, courts do not bother interpreting contract terms when the parties agree about what they mean! Courts do not have time to waste. In general, courts resolve the issues that are actually in dispute between the parties to a contract, and nothing else.

In particular, courts may need to use rules of interpretation to decide:

(1) if there is an enforceable contract; and/or

(2) what an enforceable contract means.

These two issues are briefly discussed below.

A court may have to interpret disputed parts of an agreement simply to determine whether the agreement is enforceable. As explained in earlier Chapters, courts generally will not enforce agreements that are void, or voidable where a party has avoided them. And if a court decides that

a disputed part of an agreement makes the whole agreement unenforceable, the court will stop, and of course will not enforce the agreement. An example would be if a potentially illegal part of an agreement was not clear. If a court interpreted the unclear provision to be illegal, it could not be enforced. Of course, sometimes an unenforceable part of an agreement can be severed or reformed. In that situation, a court would proceed to enforce the contract that remained.

If there is an enforceable contract, but the parties do not agree about what it means, then the court must interpret the contract in order to find out how to enforce it. Usually, when a dispute about interpretation comes to court, at least one party is arguing that the other party failed to perform according to the contract. The other party is likely to argue that she did perform properly, based on what she thinks the contract means. Obviously, a court cannot decide fairly whether a party has properly performed a contract unless the court is sure what the contract required the party to do. Likewise, a court cannot order a fair and appropriate remedy unless it knows exactly how a party's performance differed from what the contract required. So interpretation can be a crucial step in the process of contract enforcement. Performance will be discussed in detail in Chapter 9 ("Performance and Discharge of Duties"), and remedies will be discussed in Chapter 10 ("Remedies").

*** ***ADDITIONAL REFERENCE:*** Chapter 5 (“Legality”), Section 5.5b, and Chapter 7 ("Other Contract Formation Problems"), Section 7.7c discuss severance of contract terms; Chapter 9 ("Performance and Discharge of Duties") contains further discussion of contract performance; and Chapter 10 ("Remedies") contains further discussion of remedies courts may order, including severance in Section 10.7c.

8.3 Some Basic Rules Courts Use to Interpret Contracts

Interpreting contracts can be easy or difficult, depending on how the parties made the agreement. For example, when parties put their contract in writing and use clear words, it may be fairly easy to determine what each party was supposed to do. But when parties make a contract that is not so clear, it can be difficult to determine the terms of their agreement.

Free market jurisdictions have developed rules of interpretation to help courts resolve disputes about the meaning of contracts in a fair, reliable way. Although the rules may vary in different jurisdictions, many jurisdictions apply some of the same basic rules. Depending on the circumstances in a case, a court may use one or more of the rules of interpretation discussed in the following Sections to resolve disputes between parties about the meaning of a contract. In fact, courts use as many rules as they need to resolve such disputes, unless that would violate one of the rules themselves. Of course,

there are rules of interpretation that are not discussed in this text. The rules below are only some of the more important ones.

Before discussing these basic rules, it is important to stress again the basic principle that courts cannot generally get involved in a contract dispute unless a party involved in the dispute formally asks the court to help. The court cannot decide by itself to interfere.

8.3a Rule Number One: Courts Try to Interpret Contracts So That They Are Valid and Reasonable, but Courts Cannot Simply Interpret Contracts Any Way They Wish

Courts try to interpret agreements so that they are valid and reasonable contracts, if possible. For example, if an employment contract required an employee to work "full time," a court would probably interpret that term to comply with any statutory requirements about the maximum number of hours such an employee was permitted to work. And if a cyclo driver agreed to take a passenger to Old Market for 500 riels, courts would probably interpret Old Market to mean the one in the area where the parties were--not one hundreds of kilometers away.

However, an important limit on courts' interpretation power is that a court must base its interpretation on the contract itself. This key principle means that a court generally can enforce only the agreement that the parties made--not what one party later wants, and not something that the court thinks is better. There are a few limited exceptions, such as situations where courts may reform or sever agreements, or supply certain terms, as discussed in Sections 8.3 and 8.5 below. But in general, courts can enforce only what the parties agreed. This is true even if the result is difficulty or loss to one or more of the parties.

Another result of the above limit is that courts cannot generally use their interpretation power to make an invalid contract valid. So if it is clear that an agreement is invalid for reasons such as lack of capacity or legality, courts cannot generally interpret the agreement so that it becomes valid. Of course, there are some limited situations where courts may enforce promises or impose contract obligations even though there is no valid agreement about those obligations, such as where promissory estoppel or quasi-contract apply. But if none of those special situations applies, courts have no power to create an enforceable agreement merely because they wish to do so.

*** ***WHY IS THIS IMPORTANT?*** Why can't courts interpret contracts any way they wish, and why will they generally enforce only agreements the parties made?

The main reason courts generally enforce only the agreements parties actually make is freedom of contract. Parties generally know what they want their agreements to say. But in order for parties to make agreements that

do what they want, the parties need to be confident that no one--not even a court--has unlimited power to interfere and impose different ideas. That would be counterproductive, and unfair to the parties. In fact, parties' confidence that courts will not do that is at the heart of business and economic activity all over the world. And the basis for that confidence is the freedom of contract, which even the courts must respect.

Another reason for this rule is that it would usually be very difficult, and often waste a court's time, for a court to create contracts for the parties. That is not generally the function of courts in free market jurisdictions.

*** ***ADDITIONAL REFERENCE:*** Chapters 1-7 describe the major elements of enforceable contracts, and the few situations where courts enforce promises or impose contract obligations even though there is no valid agreement about those obligations.

8.3b Rule Number Two: If the Meaning of a Disputed Term Is Not Clear from the Contract, Many Jurisdictions Say the Interpretation of That Term Should Be Subjective, but If That Is Not Possible, Then It Should Be Objective

Many jurisdictions say interpretation of disputed terms should be subjective--based on the actual intentions of the parties--but if that is not possible, then it should be objective--based on what reasonable people generally intend in similar situations. This rule is difficult, but important. Of course, different jurisdictions have different rules in this area. So it is important to check the local law.

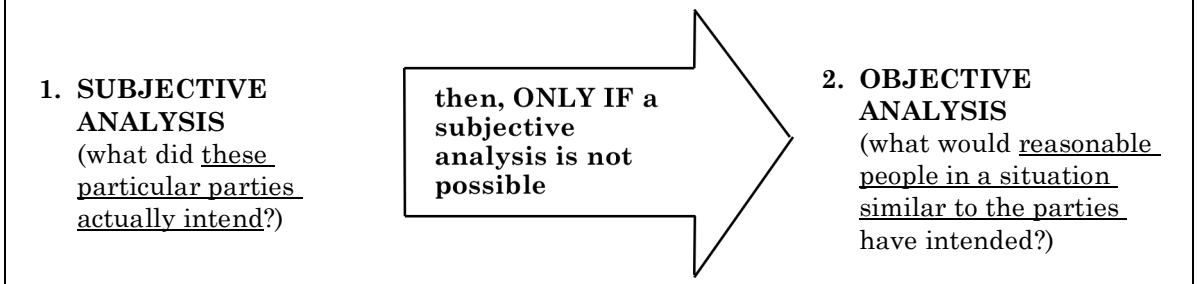
*** **DEFINITION:** A **subjective interpretation** of an agreement is one based on what the parties themselves actually intended in their particular situation.

*** **DEFINITION:** An **objective interpretation** of an agreement is one based on what reasonable people normally intend in situations similar to the situation of the parties.

Many societies have struggled with the question of how courts should interpret terms in contracts when the parties do not agree about the meaning: subjectively or objectively? For example, consider Case Study 31, the "what is chicken?" case. In that situation, courts might try to determine the meaning of "chicken" subjectively or objectively. The subjective analysis would ask what the parties actually meant when they used the word "chicken" in their contract, looking at things like what the parties now say they meant. The objective analysis would ask what reasonable people normally mean when they use the word "chicken" in situations similar to that of the parties, looking at things like accepted reference books.

Many jurisdictions appear to have decided on an approach to this problem which might be called a "subjective, then objective" approach. In these jurisdictions, when a court tries to interpret a disputed part of a contract, the court first looks at evidence of the subjective intentions of the parties. Then, only if the court cannot interpret the contract that way, the court performs an objective interpretation of the contract.

Illustration: Basic Rules about Interpretation of Contracts (Many Jurisdictions)



*** ***WHY IS THIS IMPORTANT?*** Why do many jurisdictions use this "subjective, then objective" approach to the interpretation of contracts?

Under the "subjective, then objective" approach to contract interpretation, the actual intentions of the parties in making a contract are generally more important than the intentions of other people in similar situations. This is part of the freedom of contract: the law wants to help the parties enforce the contract rights and duties they want--not ones that someone else wants. So if the real intentions of the actual parties can be determined, then the court need not ask what some other "reasonable" people would have meant. The disadvantage of the subjective analysis is that it can be very hard to determine what the parties actually meant when they made the contract. So the results of this analysis might be uncertain or inaccurate. Even so, it appears that many courts start with the subjective analysis.

But if such courts cannot resolve an interpretation problem reliably using a subjective analysis, then they turn to an objective analysis. The objective analysis is not based on what the particular parties in the case actually intended. So in a way, the objective analysis is not as good a way to determine what a contract meant to the parties themselves. However, the objective analysis is often easier to perform. And it may be more efficient and certain. For example, it is easier to look in a dictionary for the reasonable, ordinary meaning of a disputed term than it is to try to decide whether parties are telling the truth about what they actually meant in their contract. And in practice, many--if not most--disputes about the meaning of contract terms must still be resolved using an objective analysis.

(1) An Example of the "Subjective, Then Objective" Approach

The "subjective, then objective" approach many courts use to interpret contracts can actually involve several specific steps. An example of this approach which is used in many jurisdictions in the United States is explained in three steps below. At each step, if the court can interpret the meaning of the disputed term, the court stops and does not proceed to further steps.

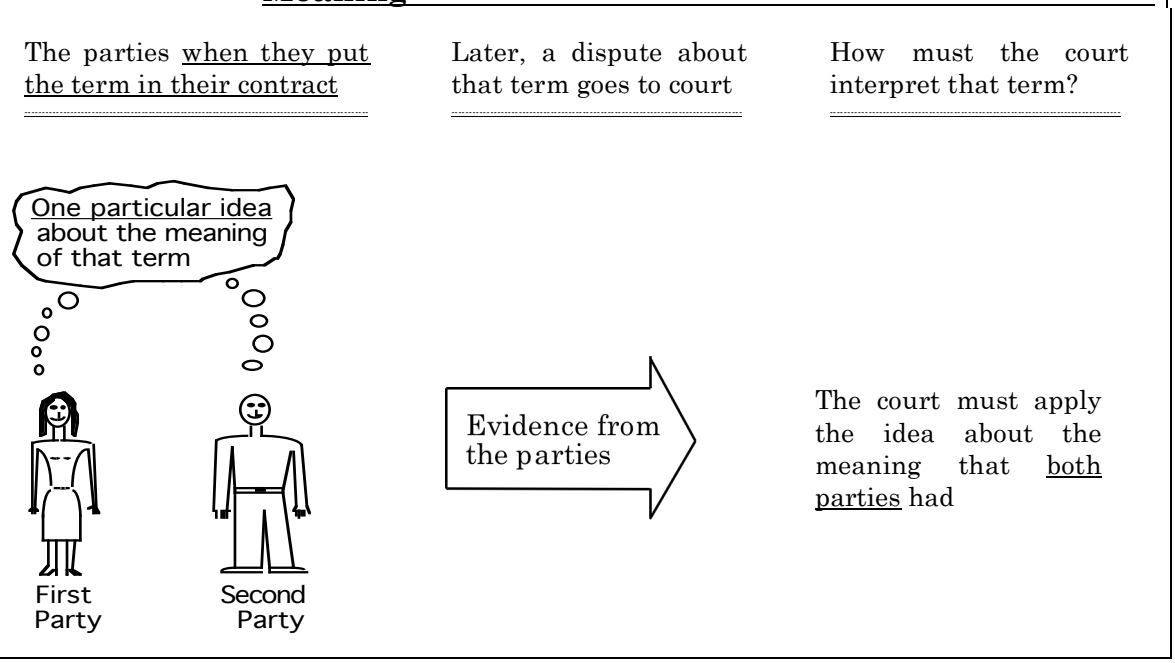
Step One -- If the evidence shows that the parties to the contract actually had the same understanding of the disputed term when they made their contract, then that is the meaning the court enforces. This is a subjective analysis, because it asks what the parties themselves actually intended the term to mean when they put it in their contract.

It appears that evidence of this intent would be found mostly in the testimony of the parties about what they meant. In practice, it is often difficult to find reliable evidence of this. That is because parties tend to say they had whatever intention will now help them by the time a dispute arrives in court. So often disputes cannot be resolved in this first step.

Common law courts might have this question resolved by a "jury." A jury is basically a small group of ordinary citizens assembled to decide important questions of fact in some court cases. Civil law jurisdictions generally do not use juries.

The following chart shows how Step One in this analysis works.

Illustration: When Courts Will Enforce BOTH Parties' Idea of Meaning



If the evidence does not show that both parties had one particular idea about the meaning of the disputed term at the time they made their contract, then the court goes to the next step.

Step Two -- The second step in this process is more difficult. Under this step, if the evidence shows that, at the time of the contract:

(1) the parties had different ideas about the meaning of a disputed term (subjectively);

AND (2) (a) the second party knew the first party's idea but the first party did not know the second party's idea (subjectively); or

(b) the second party should have known the first party's idea, but the first party had no reason to know the second party's idea (objectively);

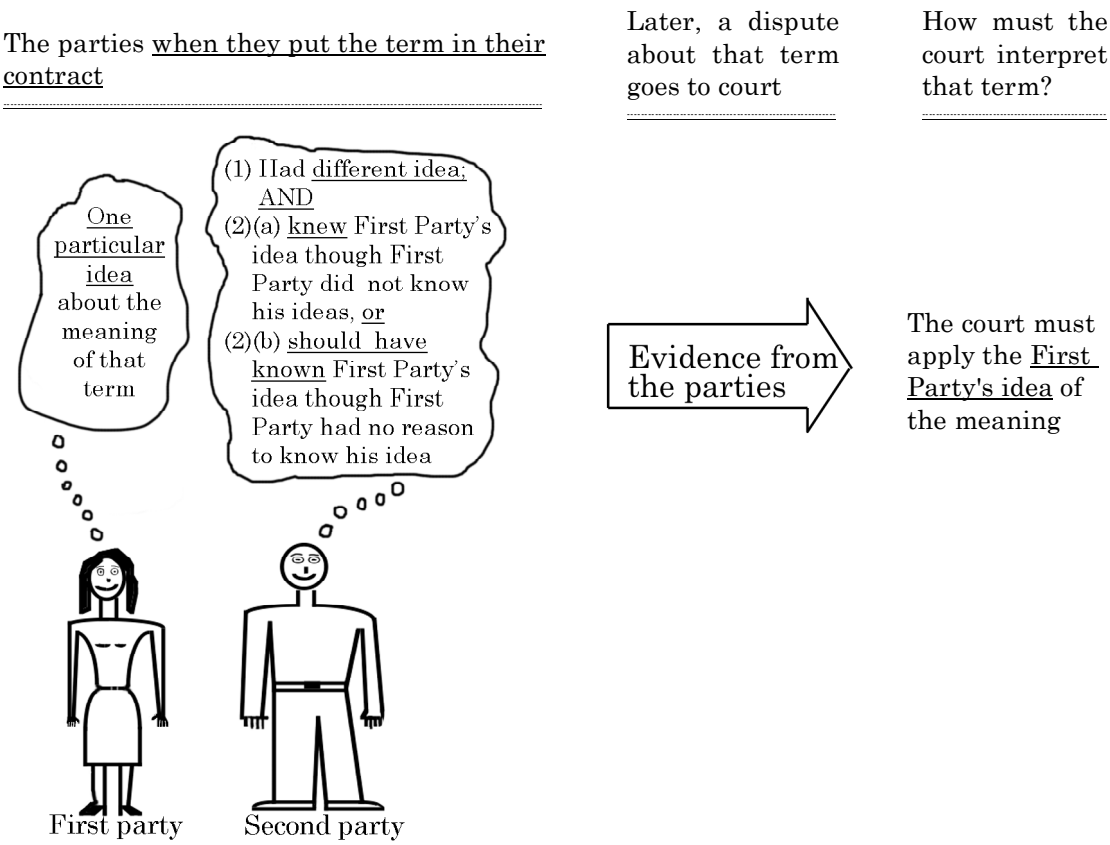
then the first party's meaning is the meaning that the court must enforce.

As noted above, this Step requires a partly subjective, partly objective analysis of the evidence. The subjective analyses in parts (1) and (2)(a) above would appear to be based primarily on testimony of the parties about what they actually meant when they made the contract. If parts (1) and (2)(a) above are satisfied, there is no need to determine whether part (2)(b) is satisfied. However, because it is so difficult to find reliable evidence of the parties' subjective intentions, it is often necessary to go at least as far as part (2)(b) to resolve disputes about the meaning of disputed terms.

Part (2)(b) is an objective test. Basically, the test requires the court to ask whether the first party's meaning is reasonable and the second party's meaning is not reasonable. Specifically, if the first party had an idea about the meaning of a disputed term, and the second party had reason to know of the first party's idea--even though the first party had no reason to know of the second party's idea--then the court must interpret the term to mean what the first party thought it meant. Basically, the court tries to determine what reasonable people would have thought the disputed term meant if they had used it as the parties did. To do this analysis, courts use the rules of interpretation explained in the rest of this Chapter. In common law jurisdictions, the objective rules of interpretation explained in the rest of this Chapter are generally applied by courts, not juries.



Illustration: When Courts Will Enforce ONE Party's Idea of Meaning



If the evidence does not clearly show that the parties had the understandings above about the meaning of the disputed term, then the court goes to the next step.

Step Three -- If the court cannot resolve the dispute about a contract term using the steps above, the court must make an objective interpretation of the meaning of the disputed term. If a court takes this third step, it may mean that it cannot be reliably determined what the parties' ideas about the disputed term really were. Or it may mean that the parties had different ideas about the meaning of the disputed term, and both ideas were reasonable or neither was reasonable! Despite these types of problems, if a court can interpret the meaning of the disputed term based on objective rules, the court will do so. It is even possible that a court will find the disputed term had an objective meaning that neither party actually intended, though that seems very unlikely.

In this objective analysis, the court tries to determine what reasonable people would have thought the disputed term meant if they had used it

as the parties did. To do this analysis, courts use the objective rules of interpretation explained in the rest of this Chapter.

*** ***CASE STUDY 178***

FACTS Vantha goes to a bread seller named Samneang, looking for some big loaves of bread. At Samneang's bread stand, she has two piles of bread: one pile of big loaves, and one pile of small loaves. Vantha points at the pile of big loaves and says she will pay 700 riels for two loaves of bread "like that." Samneang sees where Vantha has pointed. Samneang then says she will sell two loaves of bread for 800 riels. Vantha agrees. Vantha pays the 800 riels, but Samneang gives her two small loaves of bread! Samneang says she meant the small loaves, and Vantha says she meant the big loaves. The parties ask the court to interpret the agreement.

QUESTION OF LAW What did "bread" mean in this agreement?

DECISION The court would probably interpret "bread" to mean the big loaves of bread here, using the "subjective, then objective" analysis outlined above.

When there is a dispute about the meaning of a contract term, many courts use a "subjective, then objective approach" to resolve the dispute. The example of this approach discussed in this text can take up to three steps.

In the first step, there is a determination of whether the parties both had the same particular (subjective) understanding of what the term meant when they made the contract. Here, the term in dispute is "bread." Vantha says she meant big loaves, and Samneang says she meant small loaves. It might be decided that, based on this evidence, both parties meant big loaves when they made the contract--even though Samneang now claims otherwise. If that was decided, the court would apply that meaning to the contract and stop. But if there was not enough reliable evidence to make that finding--such as if it was not clear which party was telling the truth--then the court would proceed to the second step.

Under the second step, the court first asks if the parties had different (subjective) ideas about the disputed term when they made the contract. If the two parties did have different understandings about a disputed term, and either the second party knew the first party's idea even though the first party did not know the second party's idea (subjectively), or the second party should have known the first party's idea even though the first party had no reason to know the second party's idea (objectively), then the court must apply the first party's idea as the correct meaning.

In this case, it might be decided that the parties had different ideas about the meaning of "bread." Specifically, it might be decided that Samneang meant small loaves (since Samneang now says she meant small loaves),

and Vantha meant big loaves (since Vantha now says she meant big loaves). It might also be decided that, at the time the contract was formed, Samneang actually knew that Vantha meant big loaves, but that Vantha did not know that Samneang meant small loaves. If that occurred, then the subjective part of the second step would be satisfied, and there would be no need for the court to proceed. In that case, the court would find that "bread" in this contract meant big loaves.

However, if it could not be reliably determined whether Samneang actually knew about Vantha's idea that "bread" meant big loaves, then the court would have to perform the objective analysis in the second step. To do that, the court would ask whether reasonable people in the positions of Vantha and Samneang would have had reason to know about the other party's understanding of the term "bread" in the contract. The court would use different objective rules of interpretation, which will be explained in the rest of this Chapter. But basically, it seems likely that the court would find that Samneang should have known Vantha meant large loaves, because Vantha had just pointed at the pile of big loaves and made an offer to buy bread "like that." And it also seems likely that Vantha had no reason to know that Samneang meant the small loaves, because of Vantha's own words and conduct, and because Samneang never said or did anything to indicate she meant small loaves. So it seems the court would probably find that "bread" in this contract meant what Vantha says it did: big loaves of bread.

If the court could not interpret the contract in these first two steps, then it would proceed to the third step, which is to interpret the contract based on objective rules of interpretation, as discussed in the rest of this Chapter. If the court did that, it seems likely that it would still find that "bread" meant big loaves, because of the evidence that Vantha had pointed at the big loaves of bread and asked for bread "like that," and that Samneang had seen her do it. So even if the court reached this third step, it would probably find that "bread" meant "big loaves of bread" here.

8.3c Rule Number Three: In Interpreting Contracts, Courts Consider the Whole Contract

Although courts are permitted to interpret only the specific terms that the parties dispute in their contract, as discussed in Section 8.2, courts must interpret such terms by seeing how they fit into the whole contract. That is, in order to learn what such disputed terms mean, the court must look at everything the parties put into their contract. This rule reduces the risk that courts will make an incorrect interpretation because they have considered only part of a contract.

Sometimes the contract itself clearly defines or explains the disputed term. In that situation, that definition or explanation is the meaning that the court must enforce. For example, many written contracts contain an entire section with special definitions of important words or phrases in the contract.

This is often true in business contracts, and contracts whose subject matter is very technical. Unfortunately, sometimes even these definitions are not clear enough for the court to find the meaning on that basis alone!

Some parties do not put their entire contract in one place or in one form. For example, a contract may be partly written and partly oral. In that situation, the court must consider both the written and oral parts, assuming that is permitted by other rules such as the parol evidence rule, which will be explained in Section 8.4b below.

In addition, in cases involving written contracts, parties may use several documents to express their agreement. So the contract may consist of more than one document. This was already discussed briefly in Chapter 6 ("Formality"), Section 6.6a, which explained that the law is generally flexible about the form of writings, and that a contract may meet writing requirements even if it consists of several writings. Examples of contracts that often consist of more than one document are contracts involving large scale construction or the sale of goods. So if there is a dispute in such a case, the court must consider all of the documents.

******* ***CASE STUDY 179***

FACTS The Kompong Construction Company and Sok Phi Investors made an agreement for Kompong Construction to build a large hotel and casino on an island which Sok Phi owned in the Gulf of Thailand. Sok Phi agreed to pay Kompong $30,000,000 for the project.

When the parties were negotiating their contract, Sok Phi stated that it required the new hotel and casino to be built with the same high quality designs and materials as another one of its properties in Europe. Sok Phi gave Kompong a written description of these designs and materials entitled "Construction Plans and Specifications."

Later, in the parties' two-page written contract for the construction, they inserted a clause which said that "construction shall be according to Sok Phi's 'Construction Plans and Specifications,' which are incorporated herein by reference." That was the only place in the two-page document that said anything about the construction design or materials. Both parties signed the two-page document, but nothing else.

Kompong finished the construction, and Sok Phi paid the $30,000,000. But three years later, the hotel suddenly collapsed in a mild storm! Both the government and Sok Phi's own experts investigated the disaster. They discovered that Kompong had used designs and materials of only average quality when it built the hotel--not the high quality designs and materials specified in Sok Phi's "Construction Plans and Specifications"--and that was why the hotel collapsed.

Sok Phi demanded compensation from Kompong. But Kompong refused, insisting that only the two page document that the parties had signed was valid, and that that document really had no specific requirements about the designs and materials of the hotel and casino. The parties asked an arbitrator to resolve their dispute.

QUESTION OF LAW Would the arbitrator consider more than one document in order to interpret this contract?

DECISION Yes. The contract here included both the two-page document the parties signed and Sok Phi's "Construction Plans and Specifications," so the arbitrator would have to consider both documents to interpret the contract.

When parties ask a court or other decision-maker to interpret their contract, the court or other decision-maker must consider the entire agreement of the parties. This may involve examining more than one document, because sometimes parties express their agreement in more than one document.

In this case, Kompong and Sok Phi agreed that their contract would "incorporate by reference" the "Construction Plans and Specifications" mentioned in the two-page document they signed. So the "Plans and Specifications" were actually part of the contract, even though they were physically separate from the main contract document. To resolve this dispute, the arbitrator must examine the main document and the "Plans and Specifications." When the arbitrator does that, she will probably find that Kompong did not follow the contract.

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality"), Section 6.6a explains that writing requirements may be satisfied by several different writings.

8.3d Rule Number Four: In Interpreting Contracts, Courts Try to Avoid Inconsistency between Terms

Courts try to interpret contracts so that different parts of the contract do not conflict with each other, if it is reasonable to interpret the contract that way. For example, suppose there is a written contract for the sale of mangoes, and the contract contains several references to mangoes and one reference to durians which is obviously a mistake--since the contract is clearly not about durians. In that case, the court will probably interpret that reference to "durians" to mean "mangoes." Of course, it must be clear that the reference really is a mistake, which may depend on a careful reading of the whole contract, as discussed in Section 8.3c, above.

Of course, this rule does not mean that courts can avoid all inconsistencies or conflicts in a contract. For example, where a conflict between two material (important) terms in a contract cannot be resolved,

the court cannot interpret that part of the contract. In fact, courts generally cannot enforce such contracts at all, because they are probably not definite and reasonably clear. And there is usually no practical way the court can sever the part that cannot be interpreted. This is discussed in more detail in Section 8.5, below. The following Case Study illustrates this basic limit on the ability of courts to resolve inconsistencies.

*** ***CASE STUDY 180***

FACTS Pin Vipheak signed a contract to sell 200 hectares of good land in Battambang to Tung Yun. One clause of the contract stated that the purchase price was $100,000. Another clause stated that the price was $450 per hectare--which would result in a total price of $90,000. So there was a $10,000 difference between the two prices in the contract.

Tung Yun tried to pay the lower price ($90,000), and Pin Vipheak demanded the higher price ($100,000). There is no reliable evidence to show what the parties actually intended when they made the contract, and no other objective rule can resolve the conflict. The parties ask the court to interpret their contract.

QUESTION OF LAW Can a court interpret the price term in this contract and enforce the contract?

DECISION No. A court cannot interpret or enforce this contract, because there is no way to reconcile the two different price terms.

A court cannot generally interpret a contract which describes the same material term in two completely different ways, where there is no way to resolve the conflict. In this case, the contract states two completely different prices for Pin Vipheak's land--a material term--and it is impossible for the court to resolve the fundamental conflict about the price. This means the contract is not definite and reasonably clear. And the court cannot sever the price term here--it is central to the agreement. So the contract cannot be enforced. This situation could also be analyzed as a bilateral mistake so serious that the court cannot fairly enforce the agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.3a discusses the validity of agreements resulting from bilateral mistakes about the meaning of material terms.

8.3e Rule Number Five: When Terms in a Contract Conflict, Courts Value Certain Types of Terms More Than Other Types of Terms

When a court interprets a contract, it looks carefully at all of the terms in the contract. Of course, these terms can be different: some are more specific than others, and some are expressed differently from others.

In particular, certain types of statements show that they have greater value to the parties, because they show more recent agreement, or more specific detail or attention by the parties. When there is a conflict between terms that have different values, many courts will interpret the weaker term to agree with the stronger term. In other words, the stronger term wins. So in this special situation, courts can enforce the terms even if they conflict! But if conflicting terms do not have different values, then it may not be possible to resolve the conflict, as discussed in Section 8.3d, above, and Section 8.5, below.

Courts have some general rules about which types of terms have more value than others. Following are brief explanations of two of the most important of these rules.

(1) Specific terms are valued more highly than general terms. For example, part of an employment contract may say that a permanent employee must work "every day in the work week (Monday through Friday)," but another part of the contract may give the employee 15 specific holidays each year (such as the anniversary of the Paris Peace Accords). If these 15 specific holidays include some that occur during the normal work week (Monday through Friday)--meaning the terms conflict--then the more specific "holiday" term will outweigh the more general "work week" term. In other words, the contract does not require the employee to work on the 15 specific holidays, even though they occur during the normal work week. So a court would enforce the holiday term, and interpret the work week term to agree with it.

(2) Terms which the parties negotiated separately from most of the contract or added to a previously prepared form are stronger than terms the parties did not negotiate separately or which were already on the form. When parties negotiate terms separately from most of the contract, or add them to a form that was created previously, those terms are valued more highly than other terms.

As part of this general rule, many jurisdictions say that handwritten terms are stronger than typewritten terms, and typewritten terms are stronger than terms on a pre-printed "standard" form (such as those that may result in adhesion contracts). The reason for this is that when terms are added separately or later, it usually means the parties gave those terms closer and later attention, and that they intended those terms to be stronger than any conflicting ones. This important rule is illustrated in the following Case Study.

******* ***CASE STUDY 181***

FACTS The World Agency for Development (WAD) signed a contract with the owner of the Bopha Tower to rent five floors of the Tower for three years. The lease contract was a pre-printed, standard form, with some blanks filled in by typewriting.

A pre-printed clause in the contract required WAD to pay Bopha one lump sum payment of three months rent within 15 days of the signing of the contract, then monthly rent on the first of the month beginning in the fourth month of occupancy. But a typewritten part of the form only required WAD to pay the first month's rent on the day WAD was to move into the building three weeks later, and to pay rent monthly in the same way for the rest of the contract.

Three weeks after the contract was signed, as the WAD staff was moving its equipment into the Tower, the Tower's owner appeared and demanded immediate payment of three months rent! WAD refused, and the owner asked the court for help.

QUESTION OF LAW Does this contract require WAD to pay three months rent within the first 15 days of the contract date, as stated in the pre-printed language?

DECISION No. The court will interpret the lease contract to require payments by WAD on the first day of each month, as the typewritten part of the contract says, because terms that are added to pre-printed forms by the parties are valued more highly than pre-printed terms.

When a contract contains conflicting terms, courts consider the types of the conflicting terms to see if one is valued more highly than another. In particular, separately negotiated terms and terms added later to a pre-printed form are stronger than other terms.

In this case, the conflict is between statements in WAD's lease of part of the Bopha Tower. One statement was pre-printed (the lump sum payment of 3 months rent). The other statement was typewritten later (the first month's rent to be paid on the day WAD moved in and monthly thereafter). While the pre-printed statement was obviously prepared at some time in the past for use in Bopha's leases generally, the typewritten statement was added recently to WAD's specific contract, which was actually signed by both parties in this transaction. The typewritten statement has greater value than the pre-printed statement. So the typewritten term will win. WAD need not make the lump sum payment.

8.3f Rule Number Six: If the Meaning of a Disputed Term Is Not Clear from the Contract, Courts Consider the Ordinary Meaning That a Reasonable Person in the Parties' Situation Would Understand the Term to Have

This rule is also called the "plain meaning" rule. Under the plain meaning rule, when the meaning of a disputed term is not clear from the

contract, the court may make an objective interpretation based on the term's recognized or commonly accepted meaning. In doing so, the court may use:

(1) the commonly accepted meaning, for ordinary terms; and

(2) the recognized technical meaning, for technical terms.

In particular, courts use standard, accepted reference works such as dictionaries, technical manuals, statutes, and government regulations for this purpose. Consider the following Case Study.

*** ***CASE STUDY 182***

FACTS The facts are the same as in Case Study 31, the "what is chicken?" case. As the reader will no doubt recall, a chicken producer named Sombok and a restaurant owner named Cheep agreed that Sombok would supply Cheep with 500 "chickens" each month for one year.

But after the first delivery, a dispute arose about the meaning of "chicken" in the contract. Cheep said he meant young chickens, but Sombok had delivered old chickens, which Sombok claimed satisfied the contract.

QUESTION OF LAW Did this contract require Sombok to deliver young chickens?

DECISION No. The contract did not require the delivery of young chickens because that is not what "chicken" meant in the contract, based on all the applicable rules of interpretation, including the plain meaning of "chicken."

If the meaning of a term is not clear from the contract, courts consider the "plain meaning" a reasonable person would understand the term to have. In this case, the parties disagreed about the meaning of "chicken" in their contract. To find the plain meaning, the court looked at a dictionary, to check the commonly accepted meaning, and at Ministry of Agriculture regulations, to see if "chicken" had any special technical meaning. Neither of these standard reference works said that "chicken" meant "young chicken."

The court also looked at the surrounding circumstances, including the course of performance, the course of dealing, and trade usages (which are discussed in Section 8.3h, below). In this case, there was no helpful course of performance, since Cheep objected to the chickens right away. And there were no prior dealings between the parties. However, the trade usage relevant to this case was that, if parties like these wanted a certain kind of chicken (like "young" chicken), they were required to specify that in the contract.

Based on the above rules of interpretation, the court concluded that "chicken" here simply meant "chicken," as Sombok argued--not "young chicken," as Cheep argued. Sombok was not required to deliver "young chickens."

*** ***WHY IS THIS IMPORTANT?*** What is the effect of the plain meaning rule on parties and the interpretation of their contracts?

Probably the most important effect of this rule is that it provides an obvious starting place for the court to find the objective meaning of a term that is not clear in a contract. Often, the court can simply consult a dictionary or technical manual. Definitions in such sources should generally be well known to parties like those involved in the contract. So the rule not only helps courts be efficient in interpreting contracts, but it is generally fair to the parties as well.

In some jurisdictions, the plain meaning rule used to be the most important rule for the interpretation of contracts. In the past, many courts would focus only on the plain meaning of terms the parties used. If the "plain meaning" seemed clear, the court would not consider any other evidence--even if the evidence of the particular circumstances of the parties showed that they actually intended a meaning which differed from the ordinary meaning of the term!

But the plain meaning rule is no longer as strong in many jurisdictions as it used to be. In fact, many courts do not apply the "plain meaning" rule to a disputed contract term if the evidence shows that that would violate the actual intentions of the parties, or other objective rules of interpretation.

For example, sometimes parties do not use language in the way that is commonly accepted as "correct." In English, parties sometimes use the word "and," even though it is likely from the context that they really mean "or." For example, where a lease forbids a tenant to "fire weapons, store dangerous chemicals, and make loud noises," a court would probably interpret the word "and" to mean "or." The reason is that, in English, the "plain meaning" of the above phrase is probably to forbid the tenant to do all three of these activities--but not to forbid her to do only one! However, it seems much more likely that the parties' subjective intention--and the objective meaning based on some of the other rules in Section 8.3--would be to forbid any one of these activities, which would technically require use of the word "or." So in this situation, a court would be likely to interpret the word "and" to mean "or"--even though that may not be the "plain meaning."

Of course, the plain meaning rule is still a useful starting place for courts to make an objective analysis of disputed contract terms. And it can also help courts determine the meaning of a disputed term together with other rules, as in Case Study 182.



8.3g Rule Number Seven: If the Meaning of a Disputed Term Is Not Clear from the Contract, Courts Consider the Main Purposes of the Parties When They Made the Contract.

The main purposes of the parties when they made their contract are also important factors to consider in interpreting the meaning of disputed terms in a contract. Sometimes the contract itself describes its main purposes. Other times the court can determine the main purposes of an agreement by determining what kind of agreement it is, or by looking at other reliable evidence.

*** ***CASE STUDY 183***

FACTS After twelve years of marriage, the shop owners Samon and Vanny divorced. As part of their written divorce agreement, Samon agreed to provide a specific amount of financial support each month for the parties' eleven-year-old son Vannith, and Vanny agreed to actually take care of Vannith. The agreement did not say how long Samon's obligation lasted, but it did say that one of the agreement's main goals was to provide care for Vannith until he became an adult.

Vannith is now 18, which is the age of majority under the relevant statute. Samon has decided to stop giving money to Vanny for Vannith's support. But Vanny asks the court to order Samon to continue paying support.

QUESTION OF LAW Does the divorce agreement require Samon to continue paying support for Vannith after Vannith becomes 18 years old?

DECISION Probably not. A court would probably interpret Samon's obligation to pay to end when Vannith reached the age of 18, since one of the main purposes of the agreement was to take care of Vannith until he became an adult.

When courts interpret contracts, they consider the parties' main purposes in making the contracts. In this case, when Samon and Vanny made their divorce agreement, Samon promised to pay a certain amount each month in child support. The agreement did not specify how long Samon's obligation lasted. But the parties did state that one of their main goals was to provide for Vannith until he reached adulthood. Of course, even if they had not said that, providing for children until they reach adulthood is usually one of the main goals of divorce agreements. Adulthood is often measured by the age of majority, which is 18 years in this jurisdiction. And in fact, one of the major reasons the relevant statute defines the "age of majority" is to show that parents are responsible for the care of their children until that age. Since adulthood generally begins at the age of majority, it seems likely that the parties' divorce agreement required Samon to provide support for Vannith until he reached that age. Vannith has reached that age: 18 years. So courts

would likely interpret the divorce agreement to mean that Samon has no further obligation under the agreement to support her son.

8.3h Rule Number Eight: If the Meaning of a Disputed Term Is Not Clear from the Contract, Courts Consider All the Surrounding Circumstances, Particularly the Course of Performance, Prior Dealings between the Parties, and Trade Usages

In interpreting contracts, courts consider all the circumstances surrounding the contracts. Many different kinds of circumstances may be relevant to the meaning of terms in the contract. However, probably the three most important kinds of such circumstances--in order of importance--are:

(1) the parties' course of performance of the contract (most important);

(2) prior dealings (or course of dealing) between the parties (second most important); and

(3) trade usages relevant to the contract (third most important).

The reason for this order of importance appears to be that evidence of the parties' course of performance of a contract would be the closest evidence to the actual contract. Evidence of the parties' prior dealings would be the next closest, since it would still be about these particular parties (though not this contract). And trade usages would be least close, since those would not be about these particular parties at all. These circumstances are explained below.

(1) Course of Performance

The first kind of surrounding circumstances that many courts examine in interpreting contracts is the parties' "course of performance." Course of performance basically means any conduct by the parties after they made their contract which shows that they probably shared the same idea about a disputed term, or at least that the actions of one party are not consistent with the understanding she now says she had. In a way, this analysis seems partly subjective, since it focuses on what the particular parties probably meant, based on their actions. But the analysis is objective in the sense that it focuses on whether a reasonable person would have acted a certain way after the contract was formed if she did not have the same understanding as the other party about the meaning of the disputed term.

Often a party performs a contract in a particular way for some time before the other party objects. Sometimes this performance--and the other party's failure to object--can help the court decide the meaning of a disputed contract term.

*** ***CASE STUDY 184***

FACTS An experienced car dealer named Big Bear Car Company signed a contract to import 200 used cars per month for one year from the Terrible Tiger Car Company. The contract specified that Terrible Tiger would deliver the cars to Big Bear "in full working order with paint like new."

For the first six months, Terrible Tiger delivered the cars to Big Bear, and Big Bear accepted and sold the cars with no problem. But in the seventh month, a Big Bear customer told a Big Bear salesman that he did not like Big Bear's cars because the paint was old. Then Big Bear's President found out that although Terrible Tiger had cleaned and polished every car before delivery, Terrible Tiger had never re-painted any of the cars that Terrible Tiger had sent to Big Bear during the past 6 months!

Big Bear's President told Terrible Tiger that their contract required Terrible Tiger to re-paint all of the cars before sending them to Big Bear. In response, Terrible Tiger said that the contract only required the paint on Terrible Tiger's cars to look new, not be new. Now Big Bear is suing Terrible Tiger for violating their contract.

QUESTION OF LAW Did the agreement between Terrible Tiger and Big Bear require Terrible Tiger to actually re-paint the cars before delivering them to Big Bear?

DECISION Probably not. Big Bear's acceptance--without objection--of the un-re-painted cars Terrible Tiger sent for six months (the course of performance) suggests that the agreement did not require that the cars actually be re-painted.

In interpreting agreements, an important type of circumstance courts examine is the parties' conduct after the agreement is made, or the course of performance. In particular, where the meaning of a disputed term is unclear, courts may base their interpretations on the performance of the contract by one party, if the other party knew about and accepted that performance without objection.

In this case, Big Bear and Terrible Tiger disagree about the meaning of the words "with paint like new" in their contract. Big Bear says that it intended those words to require Terrible Tiger to actually put new paint on all the cars before sending them to Big Bear. Terrible Tiger says that those words only meant Terrible Tiger had to deliver cars that appeared to have new paint. The plain meaning of the words of the contract probably supports Terrible Tiger's idea, primarily because of the word "like."

But in addition to the words, the court will consider the conduct (course of performance) of Terrible Tiger and Big Bear during the first six months of the performance of the contract. During that time, Big Bear received and

resold 1,200 cars--none of which had actually been re-painted--and made no objection to Terrible Tiger. So it appears that if an experienced car dealer like Big Bear thought "with paint like new" meant Terrible Tiger was required to actually re-paint the cars, Big Bear would have complained to Terrible Tiger much earlier. But Big Bear did not. This course of performance supports Terrible Tiger's idea about what "with paint like new" means. In this situation, the facts show one party's (Terrible Tiger's) repeated performance, plus the other party's (Big Bear's) failure to object, even though that other party (Big Bear) had a reasonable opportunity to object. So the court will probably determine that Terrible Tiger's idea of the meaning of the disputed term is the right one, and Big Bear will not be able to get a remedy.

(2) Prior Dealings (Course of Dealing)

The second most important type of circumstance courts examine when analyzing a disputed part of an agreement is any similar prior dealings between the parties. This is also called the "course of dealing." In particular, courts look at any dealings between the parties before they made their contract which show that, in similar situations in the past, the parties probably shared the same understanding of the disputed term. Such prior dealings may suggest a reasonable interpretation of the term in the current case, or at least that one party should have known that was the understanding of the other party. Use of this analysis is especially common in sale of goods contracts.

This type of analysis is similar to the "course of performance" analysis discussed above. Both focus on a pattern of conduct by the parties and failure by one party to object. And course of dealing is also similar to course of performance in the sense that it has a subjective element, which focuses on what the particular parties in the case probably intended, based on their own actions.

******* ***CASE STUDY 185***

FACTS Three years ago, Seang Veng signed a contract with Rith Realty Co. In the contract, Veng promised to work "full time" as an agent for the company in exchange for 10% of the company's net profits. Veng worked very hard for the company, and he was very successful. In fact, Veng was so successful that Rith, the owner, did not mind when Veng privately arranged and profited from a couple of real estate sales each year. In fact, Veng's boss even congratulated him on his good luck!

Recently, Rith and Veng signed a new, more formal contract, with basically the same terms as the old contract. Veng continued to work successfully for the company, and he also completed two new real estate sales for personal profit. However, this time the boss became angry when he found out! He said that such conduct violated Veng's promise to work "full time" for Rith Realty. The boss asks the court to order Veng to give 90% of his profits from the two sales to the company.

QUESTION OF LAW Did Veng's recent private real estate sales violate his contract promise to work "full time" for Rith Realty?

DECISION Probably not. Veng's private real estate sales probably do not violate his promise because of his similar prior dealings with Rith, during which Rith made no objection to Veng's private sales activities.

When parties argue about the meaning of a contract term, a court may be able to interpret that meaning based on what those parties did together before they made the contract--their prior dealings. In this case, Veng and Rith Realty disagree about the meaning of the term "full time" in Veng's contract. In particular, Rith claims that "full time" means Veng can work only for the profit of Rith Realty. Veng says the contract has no such restriction.

One way to help resolve this dispute is to look at what Veng and his boss did under their prior contract. During the three years Veng worked under the old contract, Veng worked for Rith Realty and for himself. He made profits on a few private sales, and kept them for himself. The boss knew that, and not only did he not object--he even congratulated Veng! If the boss had wanted to make a different arrangement about Veng's private sales--or to forbid them--in the new contract, the boss could have. But he did not. It appears that the parties' prior dealings--including Rith's failure to object to the private sales--show that "full time" employment under this contract does not mean Veng is forbidden to make the private sales. So Veng will probably not be required to give Rith any profits from the two recent private sales.

(3) Trade Usages

The third most important type of circumstance courts examine when analyzing a disputed part of an agreement is trade usages or practices related to the type of contract the parties made. Courts look at such business customs to see if that will help them interpret the meaning of the disputed term.

In general, trade usages apply to a contract if they occur regularly enough, in the community relevant to the contract, that reasonable parties would expect the usage to occur in the contract. It might be difficult to decide cases like this if the parties were not from the same community. So many courts generally examine practices that relate to contracts similar to the contract of the parties in the place where the parties either made or performed their contract. Courts may also rely on industry codes and expert witnesses for evidence of such practices, as discussed in Section 8.4a below.

*** ***CASE STUDY 186***

FACTS Sombok Home Builders and Olympic Developers signed a contract for Sombok to build 50 new houses in an area near the market. The contract required "turn-key construction, which Sombok shall complete no later than 18 months after the signing of the contract." On March 1, 1994, the President of

Sombok Home Builders and one of the general partners of Olympic Developers signed the contract.

Eighteen months later, Sombok showed Olympic the 50 houses it had built--but none of them were complete! In fact, half of the houses did not have windows yet, and none of the exteriors were finished. The President of Sombok explained that his window supplier had no more of the particular window that Olympic had specified and was trying to find more, and that the exteriors had not been finished because of weather problems. The Olympic partners were furious.

Unfortunately, Sombok did not finally finish the houses until 3 months later. Olympic said that was a breach of their contract, and demanded compensation from Sombok for lost sales and damage to its reputation. Olympic said the contract required the houses to be totally finished within 18 months--ready for occupiers to "turn the keys." But Sombok refused to pay, claiming that since all the doors and locks were in place within 18 months, it was possible to "turn the keys!"

QUESTION OF LAW Did Sombok fail to complete the construction of the houses as required by its contract with Olympic?

DECISION Yes. Sombok failed to perform the contract correctly because it failed to achieve "turn-key construction" within 18 months, under the usage of trade in the construction industry.

Sometimes parties to a contract use technical terms related to their business or activity, but do not define the terms in the contract. When such parties later have disputes about the terms, courts may resolve the disputes by determining what the terms generally mean in the business or activity of the parties--the trade usage.

In this case, Sombok promised "turn-key construction" of 50 houses within 18 months of the signing of its contract with Olympic. Unfortunately for Sombok, the term "turn-key construction" is a technical term with a specific meaning in the construction industry. In the trade usage of this industry, "turn-key construction" means construction which is so complete that the owner only has to "turn the key" in the lock to open the building for use. In other words, nothing else needs to be done on the structure. Here, Sombok failed to complete the houses to that extent within 18 months. So Sombok failed to perform the contract correctly.

8.3i Rule Number Nine: Disputed Terms Are Interpreted Against the Party Who Drafted the Contract, If That Is Reasonable in the Circumstances

Sometimes contracts are drafted by only one party. In that situation, if there is a dispute about the meaning or effect of a contract term,

courts generally interpret the disputed term against the drafter, as long as that is reasonable in the circumstances. The reason for this rule is that courts assume that parties who draft contracts protect their own interests in drafting them. So courts generally act to protect the reasonable expectations of the parties who did not draft the contracts! This principle is basically applied in two rules, which are discussed below.

(1) Where the meaning of a disputed term is not clear, courts generally interpret that term against the drafter of the contract, as long as that is reasonable in the circumstances. This rule applies only where the meaning of a disputed term is unclear, and where one party drafted the contract. The rule does not mean that courts make unreasonable interpretations just so they can hurt drafters! It means only that, in choosing between reasonable meanings for unclear terms, courts generally choose the meaning that does not favor the drafter, if there is such a meaning.

For example, an insurance policy holder may sign an insurance contract drafted by the insurance company. If one provision of the policy says the coverage is "comprehensive," and there is a dispute about what the policy covers, most courts would interpret that word against the insurance company--against the drafter. Of course, that does not mean that such an insurance policy would cover all possible risks. It means only that, if the court must choose between a reasonable meaning that favors the insurance company and a reasonable meaning that does not, it will generally choose the meaning that does not favor the company.

(2) In adhesion contracts, where one party drafts the contract, many courts will not enforce terms that a reasonable other party would not expect to be in the contract, and to which that other party would not have agreed if she had known--even if the meaning of those terms is clear! This rule was already explained briefly in Chapter 7 ("Other Contract Formation Problems"), Section 7.3b, regarding unilateral mistakes that result from a failure to read the contract. Adhesion contracts are discussed in more detail in Chapter 7, Section 7.7b and Case Study 172. As explained in those Sections, adhesion contracts are those drafted by a party who has much greater bargaining power, and presented to the other party in a situation where that party has no real opportunity to bargain about the terms--which are usually standardized in a pre-printed form, and very favorable to the stronger party. Although this important rule is really about enforceability, some authorities also consider it to be a rule of interpretation, since the court might decide to enforce the contract--but without some part that is extremely favorable to the drafter.

One important kind of clause that courts encounter in this area is a "hold harmless" clause.

*** **DEFINITION:** A **hold harmless** clause is basically one in which a party agrees to be responsible for the potential legal liability of another party.

For example, one party might agree not to make any future legal claims she would otherwise have a right to make against the other party. This kind of clause is usually very important, because the party who agrees to "hold" the other party "harmless" usually surrenders great legal rights. So before a court will enforce such a surrender, the evidence must convince the court that the surrender was clear and voluntary. For example, if the evidence showed that both parties were sophisticated in contract matters, or that they had actually negotiated the "hold harmless" clause, then the court could enforce the clause. But with adhesion contracts, such circumstances often do not exist.

Hold harmless clauses are similar to exculpatory clauses. Those were explained in Chapter 5 ("Legality"), Section 5.4g, and Chapter 7 ("Other Contract Formation Problems"), Section 7.7b.

******* ***CASE STUDY 187***

FACTS Intergas, Inc., a huge foreign oil company, offered a pre-printed contract to Sure Service Stations in which Intergas promised to provide petrol to the two Sure Service Stations in Kandal Province for ten years. The Intergas representative told Hing Kosal, the owner of Sure Service, "take it or leave it!" The Intergas representative also told Kosal that the contract was the best offer that Sure Service would get, and that Intergas would wait only a short time for Kosal's decision.

The contract was written in the language of Intergas' home nation. It included a "hold harmless" clause, which said that Sure Service would not claim that Intergas was responsible for any damage or injuries that any of Intergas' employees or agents caused while doing Intergas work (such as gasoline delivery or inspection of equipment) at any Sure Service Station. On the whole, the contract seemed good to Kosal, especially because few oil companies were offering such an arrangement in Cambodia at the time. So even though Kosal was not fluent in the language of the contract and had never studied law, he signed the contract.

Two years later, a new Intergas employee started pumping gas into the wrong tank at one of Kosal's service stations, and an explosion seriously injured Kosal. When Kosal asked Intergas for compensation, Intergas said that it had no responsibility to Sure Service for the accident because of the "hold harmless" clause in the contract. Kosal brought his claim to the court.

QUESTION OF LAW Will the court enforce the "hold harmless" clause in the contract between Intergas and Sure Service?

DECISION Probably not. The clause is probably not enforceable because it is an adhesion contract term that is so unfair that Sure Service would not reasonably have expected it, nor have agreed had it known of the clause.

In interpreting adhesion contracts, many courts will not enforce parts of the contracts that a reasonable other party would not expect and not agree to if she knew. In this case, the contract between Intergas and Sure Service was a pre-printed form which a large international company presented to a small local business. The contract was written in a foreign language that the signing party (Kosal) did not understand well. It affected legal rights that Kosal had not been trained to understand. And Intergas had little competition in the area, so it had great bargaining power. Finally, Intergas told Kosal to "take it or leave it," which showed that Kosal had to accept the contract--quickly--as Intergas had drafted it, or not make the contract at all. This is an adhesion contract.

In addition, the "hold harmless" clause in the contract was severe. It stated that Sure Service would make no claims for any harm caused by Intergas' employees or agents. And Sure Service did not negotiate the "hold harmless" clause before signing the contract. In fact, it appears that a reasonable party in Sure Service's position would not have expected such a clause, and would not have agreed to such a clause if it had known of it. So the "hold harmless" clause in this case is probably unenforceable. Sure Service can seek damages against Intergas for the accident. The clause may also be unenforceable because it is an exculpatory clause which is against public policy, and because it is substantively unconscionable.

Of course, under basic principles of contract law, parties are generally responsible for all contracts that they make. But when the evidence shows circumstances like those above, courts examine the contract very carefully, and interpret it to prevent unjust domination by the party who prepared it.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.4g discusses how exculpatory clauses may be unenforceable even as to negligence if they are against public policy; and Chapter 7 ("Other Contract Formation Problems"), Section 7.3b discusses how a party may avoid an adhesion contract clause resulting from unilateral mistake, and Section 7.7b discusses adhesion contracts and unconscionability.

8.3j Rule Number Ten: Courts in Many Jurisdictions Interpret Contracts to Contain Specific Terms That the Law Requires or Allows, If the Parties Omitted Those Terms.

An important general rule of contract interpretation is that courts cannot impose contract obligations to which the parties never agreed, because of the freedom of contract, as discussed in Section 8.3a above. However, there are certain situations where the law allows--or even requires--courts to interpret agreements to contain certain terms if the parties omitted those terms from their agreement. The specific reasons for these exceptions are explained below. But in general, they are to protect the parties to the contract from certain kinds of unfairness, to protect their reasonable expectations, and to promote enforcement of contracts and efficient economic activity.

Situations where courts say (or "imply") that contracts have certain terms may be divided into two main categories:

(1) situations where the law requires courts to consider particular terms to be part of contracts, such as the duty of good faith and fair dealing; and

(2) situations where the law allows courts to provide certain kinds of terms to resolve disputes, such as the "gap-fillers" for sale of goods contracts.

These two important categories are discussed below.

(1) Many Jurisdictions Require Courts to Consider Certain Specific Terms, Such As the Duty of Good Faith and Fair Dealing, to Be Part of Contracts If the Parties Omitted Them

In many jurisdictions, the law requires certain special terms to be considered part of all contracts, or all contracts of a certain type. Two important examples of such special terms are warranties, and the duty of good faith and fair dealing.

As discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.7b, laws in many jurisdictions say that certain warranties are part of all contracts of a certain type, whether the parties actually put them in the contract or not. Examples in some jurisdictions include the warranty of merchantability in sale of goods contracts, and the warranty of habitability in residential lease contracts. Requirements like these try to protect parties from unfairness, and protect their reasonable expectations.

Perhaps the most important term that many jurisdictions consider to be part of all contracts is the implied duty of good faith and fair dealing. Good faith and fair dealing was briefly discussed in Chapter 7, Section 7.4a.

*** **DEFINITION:** The **duty of good faith and fair dealing** basically requires a party to a contract to be honest and not seek unfair advantage over the other party (good faith), and to follow reasonable standards of fair conduct in the type of contract the parties made (fair dealing).

Since many jurisdictions say this duty is implied in all existing contracts, it applies to the performance and enforcement of contracts. Common law jurisdictions generally say that this duty does not apply before a contract is formed (in the negotiation stage). Some do say the duty may apply in the negotiation of renewals of existing contracts, or to new contracts whose subject matter is related to old contracts between the parties. In addition, a violation of a duty of good faith and fair dealing is one of the requirements for a party to show that a mistake regarding a basic assumption resulted in misrepresentation in the inducement, as discussed in Chapter 7, Section 7.4a.

But in general, common law jurisdictions have other ways to regulate the conduct of parties before an agreement is formed, such as the rules about procedural unconscionability and other contract defects.

However, it appears that many civil law jurisdictions do impose duties comparable to the duty of good faith and fair dealing before a contract is formed--at the negotiation stage--and in the performance of the contract. For example, it appears that the laws of France and Germany impose comparable duties on parties at the negotiation stage, before any enforceable contract is formed.

Even within a particular jurisdiction, the rules about the duty of good faith and fair dealing do not always apply the same way. In some situations, courts may apply only the "good faith" standard, and not any duty of "fair dealing." For example, the Uniform Commercial Code in the United States seems to apply only a "good faith" requirement to sale of goods contracts generally. But where such contracts involve merchants, the Code applies that good faith requirement and a "fair dealing" requirement to the merchants.

Some types of situations where conduct violates the duty of good faith and fair dealing include: a lack of diligence in performing a contract; intentionally giving an imperfect performance of a contract; and interfering with the other party's ability to benefit from the agreement or the other party's performance. Consider the following Case Study.

*** ***CASE STUDY 188***

FACTS Two brothers named Rotana and Sochea are both famous popular singers. They make separate contracts with a nightclub owner named Vandy to sing on the same night, one right after the other.

On the night the brothers are scheduled to appear, Rotana goes first. However, because he is a big star, Rotana decides that he does not need to try very hard. So he intentionally sings badly. Vandy and her customers are very upset. In fact, Vandy is so angry that--in order to get revenge on the brothers--when Sochea gets on stage and starts to sing, Vandy tampers with the sound system so that Sochea's microphone keeps going off and on, and the volume keeps going up and down! This makes it very difficult for Sochea to sing, though he tries to do so. Of course, it also annoys the audience, but Vandy is too angry to care.

The next day, Vandy says Rotana violated his duty of good faith and fair dealing, even though there are no express contract provisions about how he was to perform. And Sochea says that Vandy violated her duty of good faith and fair dealing, even though there are no express provisions forbidding her to tamper with the sound system.

QUESTION OF LAW Did Rotana and Vandy violate their duties of good faith and fair dealing?

DECISION Perhaps. Some jurisdictions might say that Rotana and Vandy violated their duties of good faith and fair dealing, even though it appears that they violated no express provisions of their contracts.

Many jurisdictions say that a duty of good faith and fair dealing exists in all contracts. In this case, Rotana and Sochea agreed to sing at Vandy's nightclub. But Rotana intentionally sang badly. Even though it appears that he met the express requirement of the contract--that he "sing"--a court might find that he had intentionally rendered an imperfect performance, performed with a lack of diligence, and interfered with Vandy's right to receive the benefits of her agreement: a good performance and happy customers. Some courts might find that this violated his duty of good faith and fair dealing.

And Vandy intentionally interfered with Sochea's performance by tampering with the sound system, making it very difficult for Sochea to sing. Although no express provision of the parties' contract discussed this, Vandy's actions interfered with Sochea's performance, and prevented him from receiving all the benefits of the agreement, since one of the benefits of such agreements is the opportunity to build and maintain a good reputation as a singer. So some jurisdictions might say that Vandy violated the duty of good faith and fair dealing.

In general, the actions of Rotana and Vandy do not show "good faith," and do not follow reasonable standards of fair conduct for this type of contract. So some jurisdictions might find that they violated the duty of good faith and fair dealing.

Many jurisdictions say that, in certain special situations, to breach a contract in violation of the duty of good faith and fair dealing--in "bad faith"--is actually a tort. However, courts have had trouble defining exactly when the tort exists. Most courts have been careful to limit this tort to certain types of cases. Basically, these cases seem to occur where:

(1) there is some special relationship between the parties to the contract which involves elements such as the public interest and adhesion;

or (2) a party's conduct in breaching is notably malicious, oppressive, unreasonable, or unjustifiable.

Probably the most important area in which courts have found this to occur is in insurance contracts. It may occur where an insurance company refuses in bad faith to pay a claim submitted by one of its policyholders. Another situation where some courts have found the tort of bad faith to exist is where a party denies without any legitimate reason that a contract even exists. In situations like these, punitive damages may be available, even though

punitive damages are not generally ordered in contract disputes. This will be discussed in more detail in Chapter 10 ("Remedies"), Section 10.5d.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.4a discusses the duty of good faith and fair dealing in the context of misrepresentation in the inducement, and Section 7.7b discusses the warranties that may be implied in certain types of contracts; Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c discusses how the duty of good faith and fair dealing affects contract performance; and Chapter 10 ("Remedies"), Section 10.5d discusses how a bad faith breach of contract can be a tort in limited situations.

(2) Many Jurisdictions Allow Courts to Supply Certain Terms to Contracts in Order to Resolve Disputes, Such As "Gap-Fillers" for Sale of Goods Contracts, If the Parties Omitted Them

The law in many jurisdictions allows courts to supply certain types of terms to contracts in order to resolve disputes, if the parties omitted the terms. Although many jurisdictions did not allow this practice in the past, many courts deciding contract disputes will now attempt to supply such terms in a variety of situations, as long as it is consistent with the apparent intentions of the parties.

For example, courts in many jurisdictions will supply a "reasonable" price term to a sale of goods contract if the parties have failed to specify any price term. The reason courts are allowed to do this in certain situations is to protect the reasonable expectations of the parties. This rule also promotes the enforcement of contracts where the parties did not have time to put all the terms in their contracts, or where they simply assumed reasonable terms would apply. This is especially important in business contracts.

However, it is important to remember that courts cannot supply missing terms in every situation. In fact, they cannot supply the truly essential terms that were discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b--the terms needed for an offer to be definite and reasonably clear. For example, in most contracts, courts cannot supply a missing description of the subject matter of the contract, such as the identity and quantity in a sale of goods contract. There is generally no way for courts to determine such terms.

In addition, courts cannot supply a term which the parties themselves have already specified in their contract. This is true even if the parties have tried to specify the term, but failed to do so clearly enough for the term to be interpreted! So if the parties do say something about a term, but the court cannot interpret it under any of the rules of interpretation, the court cannot substitute its own "reasonable" term. The reason courts cannot supply terms in these situations is that the risk of harming the reasonable expectations of

the parties would be too high. If the parties have specified--or tried to specify--their own term, courts assume they do not want a "reasonable" term.

Perhaps the most important examples of this rule are the "gap-fillers" that many jurisdictions will supply for sale of goods contracts. Some commercial laws (such as the Uniform Commercial Code in the United States) allow courts to supply reasonable terms for sale of goods contracts if the parties have failed to say what they meant about certain types of terms. One way the law does this is by providing a list of specific gap-fillers that courts may supply where the parties have failed to state that specific term. For example, where a sale of goods contract has no price term, a court may be able to supply a reasonable price, as in Case Study 35. Another way some commercial laws (such as the Uniform Commercial Code) fill gaps is by allowing courts to supply missing terms by looking at the surrounding circumstances described in Section 8.3h above: the course of performance, prior dealings, and trade usages. In these ways, such commercial laws help courts resolve disputes about important terms which are missing from contracts.

*** ***CASE STUDY 189***

FACTS One day in New Market, a trader named Var Hach agrees to sell a merchant named Tung Chhay 10 cartons of videos for $500. Chhay pays Hach in advance, because Hach has a good reputation at the market. The parties say nothing about when delivery is to occur.

Three months later, Hach has not delivered the videos. So Chhay demands his money back. Hach tells Chhay to wait a little longer. But after another month, Hach has still not delivered the videos.

Finally, Chhay complains to the court, saying he has waited a reasonable time but received no videos. Hach says that the parties never agreed about a delivery date, so either their contract was void, or Hach still has time left to make the delivery.

QUESTION OF LAW Do Hach and Chhay have an enforceable contract that requires delivery of the videos to occur within a reasonable time, and did Hach fail to comply with that requirement?

DECISION Yes, in many jurisdictions. Under many commercial laws, courts imply a requirement that delivery of goods occur within a reasonable time, and in this case Hach failed to follow that term of the contract.

Commercial laws in many jurisdictions say that courts can supply certain types of terms when parties fail to include them in sale of goods contracts. One of the types of terms courts can supply is the time for delivery of the goods. If parties fail to include this term, courts say delivery must occur within a reasonable time.

In this case, the sale of goods contract does not say when Hach (the seller) must deliver the videos to Chhay (the buyer). In many jurisdictions, the court can "fill that gap" about delivery. First, the contract is not void because a "gap-filler" can supply the missing term: the time for delivery. Under this gap-filler, Hach has only a reasonable time to deliver the videos. Here, where Hach failed to deliver the videos for four months, most courts would probably say that a reasonable time has passed. So Hach has failed to deliver within a reasonable time under the contract. The court can order Hach to provide a remedy to Chhay.

These gap-fillers for sale of goods contracts are based on what is generally considered fair in commercial contracts, and on what parties usually expect when they make such contracts. The following illustration shows some important specific gap-fillers under the Uniform Commercial Code in the United States.

Illustration: Some Important "Gap-Fillers" for Interpreting Sale of Goods Contracts (U.S. commercial code)

IF neither the contract nor other evidence shows what the parties intended with regard to:	**THEN the court may imply--"fill the gap" with--the following term:**
(1) PRICE	A reasonable price at the time the seller is to deliver the goods to the buyer (See Case Study 35)
(2) TIME OF PAYMENT	The buyer must pay in full at the time the seller delivers the goods (the buyer does not receive credit)
(3) PLACE OF PAYMENT	The buyer must pay at the place of delivery
(4) TIME OF DELIVERY	The seller must deliver within a reasonable time (See Case Study 189)
(5) METHOD OF DELIVERY	The seller must deliver all the goods in one delivery
(6) PLACE OF DELIVERY	The seller must deliver the goods at the seller's place of business, or at the seller's residence if the seller has no place of business (except where both parties already know the goods are in a particular place, in which case that is the place of delivery)

*** ***WHY IS THIS IMPORTANT?*** Why do many commercial laws provide "gap-fillers" for sale of goods contracts?

Lawmakers created these gap-fillers in order to support sale of goods contracts. In fact, courts use gap-fillers to resolve disputes and enforce commercial contracts as much as possible. In addition, the gap-fillers allow parties to make more contracts faster, without having to negotiate every term in every contract. This promotes business and commercial activity. So the gap-fillers have the same basic function as many other special rules for sale of goods contracts.

Of course, it is often better for the parties to avoid "gaps" about important matters in their contracts. This is especially true when a party has a special need or goal that requires a particular term that is different from the standard gap-filler in the commercial law. In such cases, if the parties themselves do not provide the term they want, the commercial law may provide a gap-filler the parties never wanted and do not like--and then the parties must obey the contract with the law's gap-filler in it! So parties should generally try to specify exactly what they want in their sale of goods contracts, even where the law provides gap-fillers.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b further discusses how courts in some jurisdictions can supply certain terms to sale of goods contracts, and the reasons sale of goods contracts often need not be as definite as contracts in general.

8.4 Evidence Courts Use to Interpret Contracts

Below are some general principles about the kinds of evidence many courts use to help them interpret contracts. Of course, the specific rules about what evidence courts may use to interpret contracts vary in different jurisdictions. So as always, it is important to check the local law.

8.4a Courts May Use Various Types of Evidence

Courts may generally use a variety of different types of evidence to interpret contracts. Often this evidence helps them apply the rules discussed in Section 8.3. These are some important types of evidence courts may use:

(1) the contract itself (which may be oral, implied, written in one or more documents, or some combination of these possibilities);

(2) other documents that contain information relevant to the contract;

(3) testimony from the parties;

(4) testimony from other witnesses; and

(5) standard reference materials, including:

  (a) regular and technical dictionaries; and

  (b) industry manuals.

However, the rules of contract law and the rules of evidence limit the use of some of these types of evidence in interpreting contracts. Perhaps the most important single limit in common law jurisdictions is the "parol evidence rule," which is discussed in Section 8.4b below.

In addition, it appears that many civil law jurisdictions limit the use of testimony (oral evidence) in contract disputes more than most common law jurisdictions do. It seems that such jurisdictions try to resolve contract disputes primarily on the basis of documentary evidence.

8.4b Under the Common Law Parol Evidence Rule, Where a Final Writing Contains Contract Terms, a Court Cannot Generally Allow Evidence of Statements of the Parties Prior to That Writing to Contradict or Add to the Terms of a Complete Writing, or Contradict the Terms of an Incomplete Writing

In many common law jurisdictions, such as Australia, there is an important limit on how evidence may be used where there is a written contract. This is the "parol evidence rule."

In many jurisdictions, under the parol evidence rule, where a contract is written, final, and complete, a court cannot generally allow evidence of statements made by the parties prior to the signing of the writing to contradict or add to the writing's terms. Where such a writing is final but not complete, a court cannot generally allow such prior statements to contradict the terms in the writing, though they may add consistent terms.

The "statements" covered by the rule include oral and written statements. The rule covers not only brief comments by the parties, such as "delivery in three days," but also statements by the parties that actually look like full, detailed agreements. For example, if a contract is written, final, and complete, and includes a price term, a court cannot allow evidence of a different price term contained in a prior document the parties prepared--even one entitled "Agreement"--to contradict the price term in the final contract. Nor can the court allow evidence that a party said orally that the price would be some different amount just before the parties signed the final agreement to contradict the price term in the final agreement.

This rule helps protect the interests of the parties who made a final written contract. And it also helps courts interpret contracts, by encouraging parties to create a single source of written proof of the contract. Courts do not wish to go through the whole negotiation process the parties did--which may have involved large numbers of different draft documents, and many conversations--in order to find the parties' true agreement.

The parol evidence rule is difficult, but it is important to remember that it applies only in limited situations. The rule only stops courts from allowing prior statements to contradict the terms in any final writing, or add to

the terms in a complete final writing. So it does not stop the court from using such statements to decide whether a writing actually is complete. It does not stop the court from using such statements to help the court understand the meaning of the terms in the writing where they are not clear. In addition, the rule does not apply to statements made after the contract is formed, such as modifications of the agreement. And the rule does not apply to evidence used to make claims that the contract is not valid, such as claims that there are problems with legality or capacity, or other formation problems, like mistake. These limits on the parol evidence rule are discussed in detail below.

The name "parol evidence rule" may be a little confusing. The English term "parol" appears to be related to a French word meaning "oral." But the rule actually applies to prior oral and written statements that parties may seek to use in court to contradict or add to contract terms. In addition, the name might be confusing because, although the rule says it is an "evidence rule," it is generally considered to be a substantive contract law rule. This is because the rule really guides what the terms of a contract are, not just what evidence a court will consider.

(1) When the Parol Evidence Rule Applies

As noted above, the parol evidence rule applies only in particular situations. In order to determine if the rule applies, a court must answer three questions:

(1) Did the parties create a writing?

(2) Was that writing the final expression of the parties' agreement?

(3) Was that writing the complete expression of the parties' agreement?

Suppose the answer is yes to all three questions--that is, the contract is written, final and complete. In that case, the court will not allow evidence of prior statements of the parties to contradict or add to the contract terms.

Suppose the answer is yes to the first two questions but no to the third question--because there is a written and final expression of the parties' agreement, but it is not complete. In that case, the court will not allow prior statements to contradict what is in the writing. But the court will allow such evidence to add consistent terms.

Finally, suppose the answer is no to either one of the first two questions--because there is no writing, or because the writing is not final. In that case, the parol evidence rule does not apply. So the court may consider evidence about the contract according to the regular rules of evidence.

These three key questions are explained in more detail below.

(1) Is there a writing? The parol evidence rule applies only where there is a writing. So if the parties' agreement is oral or implied, the rule does not prevent the court from allowing prior statements to change the terms of an apparent contract. If it appears that a contract may be only partly written, courts proceed to the second question, because the parol evidence rule may still apply.

(2) Is that writing the final expression of the parties' agreement? The rule applies only if the writing was the final expression of the parties' agreement. To determine if the writing was a final expression, the court looks at the writing itself and all the surrounding circumstances. For example, the court may able to tell by looking at the writing that it was really intended to be a tentative draft, an outline, or a memo--and not the final expression of the parties' agreement. This requirement is important, because when parties negotiate, they often send many drafts back and forth, without intending that these drafts be the final expression of their agreement.

(3) Is that writing the complete expression of the parties' agreement? The parol evidence rule applies differently depending on whether the writing is a complete expression of the parties' agreement. Different courts use different methods to answer this question. Courts in many jurisdictions consider the writing itself; the prior statement that one party is trying to persuade the court is really part of the contract; and all other relevant circumstances.

A contract may actually have a clause called a "merger" or "integration" clause that says the writing is a complete expression. However, although clauses like this may help the court decide the answer to the third question, many courts still look at all the relevant circumstances. It is possible for a writing to have an integration clause even though the writing is not really complete! Or the writing may actually incorporate prior statements by reference--as occurred with the Plans and Specifications for the hotel and casino in Case Study 179--in which case the writing is obviously not complete.

Sometimes the writing itself provides no clear evidence about whether it is complete or not. In trying to answer the third question in that situation, the basic analysis many courts make is an objective one: whether reasonable parties in the situation of the parties to the contract would have included the prior statement in the writing.

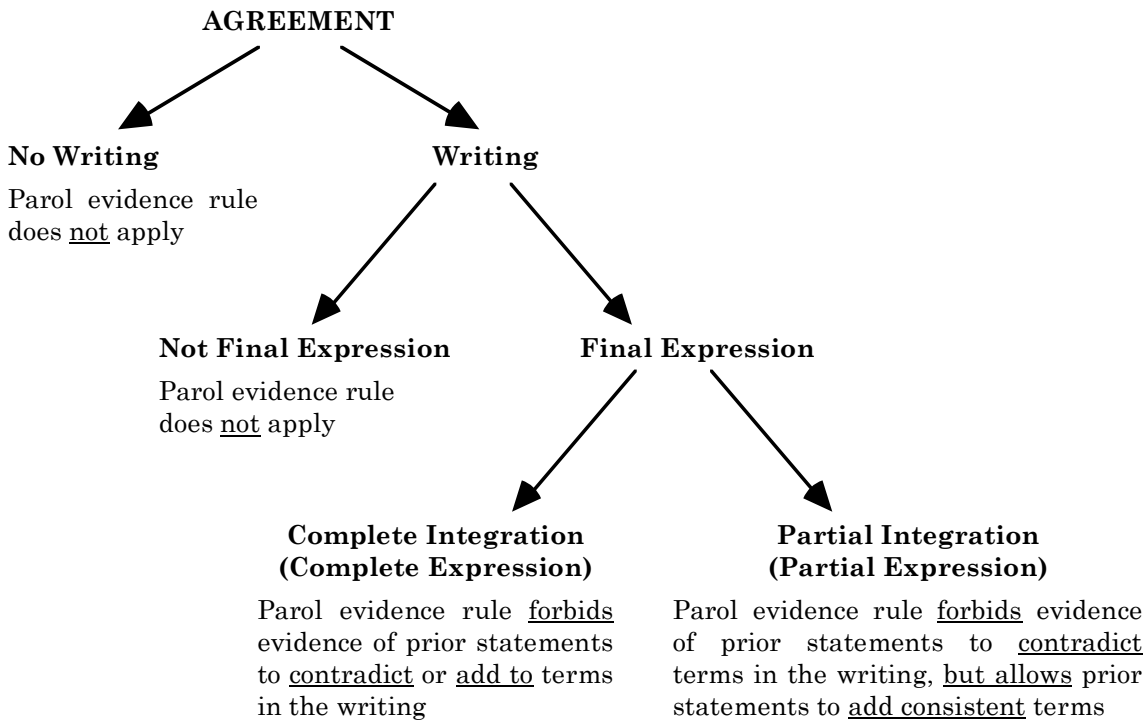
If such reasonable parties would have included the prior statement in their final writing, then the contract is called a "complete integration." In that case, courts will not allow evidence of the prior statement to contradict or add to the writing.

But if such reasonable parties would not have included the prior statement in their final writing, then the contract is called a "partial integration." In that case, courts will not allow evidence of the prior statement

to contradict the writing. However, courts will allow evidence of the prior statement to add terms that are consistent with the terms in the writing.

The following chart shows how the parol evidence rule works.

Illustration: How the Parol Evidence Rule Works



*** ***CASE STUDY 190***

FACTS Toan Song and Meas Kimyan orally discuss the possibility that Kimyan will lease Song's shophouse. One term they agree about is that the shop's electrical system is old and inadequate, so they will divide "50-50" the cost of installing a new electrical system. The parties do not reach a final agreement about the whole contract, but Song says he will have his lawyer draft and send a proposed lease.

Song's lawyer prepares a final lease contract, and sends it to Kimyan. It says that Kimyan will pay 100% of the cost of the new electrical system. But Kimyan signs the lease without reading it carefully, and without noticing the change.

Kimyan moves into the shophouse, and pays rent according to the written contract. But when Kimyan brings the bills for some electrical work to show Song, Kimyan is shocked to discover that the written contract does not require Song to pay any part of those bills. And Song's lawyer says the parol evidence rule prevents Kimyan from even presenting evidence in court about the earlier "50-50" agreement!

QUESTION OF LAW Does the parol evidence rule prevent Kimyan from presenting evidence of the oral "50-50" agreement about the electrical system which occurred prior to the final written contract?

DECISION Yes. The written contract in this case is final and complete, so the parol evidence rule does not allow Kimyan to present evidence of the prior oral agreement about the electrical system to contradict the final written agreement.

If a court determines that there is a final and complete writing of a contract--a complete integration--then under the parol evidence rule, the court cannot allow prior statements of the parties to contradict or add to the written contract terms. In this case, Kimyan and Song signed a written contract. It is obviously the final expression of the parties' agreement, because afterwards the parties began to perform the contract, and there was no further discussion of the contract terms until Kimyan brought Song the first bills. And the writing is a complete integration, because reasonable parties in this situation would clearly have put this kind of important term--about who pays to improve the property--in their final written lease contract. In fact, the writing did contain a term about who would pay for the new electrical system: Kimyan! For these reasons, Kimyan cannot present evidence of the parties' prior statements about the "50-50" payment arrangement to contradict the terms of the final writing. So under the final contract that Kimyan signed, he--and not Song--will have to pay for the new electrical system.

In fact, Kimyan's situation is precisely the kind of case for which common law jurisdictions created the parol evidence rule. And though the result may seem unfair to Kimyan, it was really Kimyan's responsibility to read the contract from Song's lawyer carefully before he signed it. Kimyan did not do that. Of course, if Kimyan had made a real agreement before signing the writing, he could ask the court to reform the writing to reflect the parties' real agreement. This is discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.3b, about mistakes resulting from failure to read agreements, and in Section 8.4b, below. But in this case, there was no full real agreement prior to the writing, though there may have been agreement about certain terms. And as discussed elsewhere, parties are generally responsible for reading what they sign. In this situation, the parol evidence rule is more concerned with protecting parties and their written contracts from false claims of outside agreements than it is with protecting parties like Kimyan from their own mistakes.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.3b further discusses the limited situations where parties can avoid contracts resulting from the unilateral mistake of failing to read the contract.

*** ***CASE STUDY 191***

FACTS Suppose the facts are the same as in Case Study 190, except that the final lease Song's lawyer drafts and the parties sign does not say that Kimyan must pay 100% of the cost of the new electrical system. Instead, the written lease says only that the cost of the new system will be paid "as per our conversation."

But when Kimyan brings Song the first bills for the electrical work, Song still says the lease does not obligate him to pay any of them. And Song's lawyer says the parol evidence rule prevents Kimyan from presenting evidence of Song's prior agreement to pay 50% of the cost!

QUESTION OF LAW Does the parol evidence rule prevent Kimyan from presenting evidence of the oral agreement about the electrical system which occurred prior to the final written contract?

DECISION No. In this situation, the parol evidence rule does not prevent Kimyan from using such evidence, because the written lease here was only a partial integration, and Kimyan can present evidence of consistent additional terms.

If a writing is a final but not complete expression of the parties' contract--a partial integration--the court can allow prior statements to add consistent terms to the writing. In this case, the writing is final. But the writing says that the costs of the electrical system will be paid "as per our conversation." That shows that the writing is not complete, because it refers to an outside source of terms. So the writing is a partial integration. Kimyan can present evidence about the prior statements--his conversation with Song--to show that their contract included the "50-50" payment term (a term that is consistent with the rest of the lease). Of course, Kimyan still cannot offer evidence of prior statements to contradict the terms in the writing.

If the writing in Case Studies 190-191 had said nothing at all about payment for the electrical system, that would be a different situation. In fact, it is a more difficult situation, but one which often occurs. In that case, a court might decide that the writing was a complete integration, because reasonable parties might include a term like this in their final written lease if they really want it to be part of the agreement. If a court did decide it was a complete integration, then Kimyan would not be allowed to use evidence of the 50-50 payment conversation to add that term to the writing. So it is always important for a party to read the whole written agreement, to make sure that all the terms that party wants are included in the writing.

*** ***WHY IS THIS IMPORTANT?*** Why do common law courts use the parol evidence rule, and how does it affect parties, contracts, and contract disputes?

The parol evidence rule exists to achieve several goals. The rule's effect on parties is to exclude certain evidence which might otherwise be used to win a contract dispute. In fact, the rule often prevents parties from trying to mislead the court, by saying that contradictory statements which occurred before final contracts were actually part of the contracts--even though the parties did not put those statements into the final writings! If such prior statements could contradict final written contracts, parties could not rely as much on their contracts.

The rule's principal effect on contracts is to strengthen the importance and the power of written contracts. The rule recognizes that when the parties make a contract that is written and final, the parties have usually chosen which terms they really want in their contract. Obviously, prior statements about terms that the parties may have changed or omitted are not as reliable as what the parties chose to put in the final contract. So the parol evidence rule generally says the courts cannot allow such statements to contradict the final writing. And where such writings are complete, prior statements cannot generally be used even to add consistent terms to the writing! This increases the power and reliability of written contracts.

The rule's effect on dispute resolution is to promote efficiency and predictability. In particular, if the parties have written a final and complete contract, the rule requires courts to resolve disputes about the contract terms by focusing on the written contract--not on prior statements and the whole negotiation process which led up to the contract! If the court tried to do that, either it would waste its time re-doing what the parties themselves already did, or it would make mistakes, and the result might be an incorrect interpretation of the contract. For similar reasons, even where a final writing is not complete, evidence of prior statements cannot be used to contradict it.

(2) When the Parol Evidence Rule Does Not Apply

As noted above, the parol evidence rule applies only in limited situations, and there are many situations where it does not apply. Specifically, the rule does not apply:

(1) where there is no writing;

(2) where the writing is not final;

(3) where the prior statements are presented to help the court determine whether the writing actually is complete;

(4) where the prior statements are presented to help the court understand the meaning of terms that are in the writing;

(5) to evidence of statements made after the time of the writing;

OR (6) to evidence used to show the contract is not valid.

Each of these situations is briefly discussed below.

(1) The parol evidence rule does not apply if there is no writing -- As discussed above, if there is no writing, the parol evidence rule does not apply. If the agreement is partly written, the rule may apply, as also discussed above. But if the agreement is completely oral or implied, or some combination of those two, then the rule does not apply.

(2) The parol evidence rule does not apply where the writing is not final -- As discussed above, the rule does not apply where the writing is not the final expression of the parties' agreement, or at least part of their agreement. Obviously the court will not order the parties to obey a writing that is not the final expression of their contract, such as a draft agreement.

(3) The parol evidence rule does not prevent the court from considering prior statements to determine whether the writing really is complete -- Courts can use evidence of prior oral and written statements to determine whether the writing is a complete expression of the parties' agreement--whether it is a complete integration, or a partial integration. It is hard for courts to determine whether reasonable parties would have included a particular term in their writing if the court cannot even consider what that term is! So courts will consider such prior statements in order to make this decision.

(4) The parol evidence rule does not prevent the court from considering prior statements to understand the meaning of terms that are already in the writing -- The rule does not stop courts from using prior oral or written statements of the parties to understand the meaning of a writing, where that meaning is not clear. The rule applies only to statements of the parties that contradict or add to the terms in the final writing. But that differs from the situation where the court needs help to understand the meaning of a writing. For example, in Case Study 191, the court used prior statements of the parties to help it understand what the term "as per our conversation" in the writing meant. These prior statements did not contradict or add to this term--they merely helped the court understand it. Courts may also use other types of prior statements, such as those made in the prior course of dealing of the parties, to help understand the meaning of a writing that is not clear.

(5) The parol evidence rule does not prevent the court from considering evidence of statements made after the writing was made -- The rule does not prevent the court from considering evidence of statements or other events occurring after the contract was formed. One example of this kind of evidence is evidence of the course of performance. But perhaps the most important type of such evidence is evidence of future agreements, including modifications of the existing agreement. This is important because parties often make such modifications.

*** ***CASE STUDY 192***

FACTS Somol Transport signed a contract with ABC Construction under which Somol promised to remove the excess material and rubble from a major construction site in the city. According to the written agreement, ABC's engineers would weigh and document exactly what Somol was removing before Somol took it away, and a Somol manager would also make his own records of the process. Basically, both parties wanted a record of how much work they were doing. However, after two weeks of this process, both parties orally agreed to stop it, because it was too slow and burdensome.

A few months later, after Somol had removed nearly all of the material, ABC claimed Somol had violated the contract by removing the material before ABC had the opportunity to make a record! When Somol mentioned the modification Somol and ABC had made after the writing, ABC said the parol evidence rule would not allow a court to consider testimony about that.

QUESTION OF LAW Would the parol evidence rule prevent a court from considering evidence of the modification the parties made after their writing?

DECISION No. The parol evidence rule does not apply to statements or agreements ABC and Somol made after their original written contract.

The parol evidence rule does not prevent the court from considering statements or agreements the parties make after the original written contract. This is true even if that original contract was final and complete, because the rule applies only to prior statements.

In this case, ABC and Somol orally modified their agreement to haul away the excess material and rubble at a construction site. Specifically, they agreed they would stop the weighing and documentation process required by the original written contract. This modification occurred after that writing was signed. So the parol evidence rule does not apply, and does not prevent Somol from presenting evidence about the later agreement of the parties.

(6) The parol evidence rule does not prevent courts from considering evidence that the contract is not valid -- The rule does not prevent courts from considering prior statements for the purpose of determining whether the contract was valid. For example, courts may consider such evidence to see if the contract was invalid because of illegality, lack of capacity, lack of consideration, or other contract formation defects, such as mistake, misrepresentation, duress, undue influence, or unconscionability.

A party can present evidence of a real prior agreement to show that she made a unilateral mistake in signing a writing that does not accurately reflect that prior agreement--even if the inaccurate writing is final and complete. Basically, the mistaken party can ask the court to reform the writing to reflect

the parties' real prior agreement. This is further discussed above, and in Chapter 7 ("Other Contract Formation Problems"), Section 7.3b.

Another important example of evidence the parol evidence rule does not prevent a court from considering is evidence that a contract is actually illegal. Consider the following Case Study.

*** ***CASE STUDY 193***

FACTS Bora and Sun sign a final and complete loan agreement. The writing says that Sun will loan Bora a certain amount of money, and Bora will repay it at 20% interest per year, which is the maximum rate allowed in the parties' jurisdiction.

However, the agreement is actually back-dated, because of a prior oral agreement between Bora and Sun that Bora would be required to pay interest at a rate far higher than 20% per year. So the real agreement is usurious, although the writing signed by the parties does not show that.

After making a few payments, Bora cannot pay any more, because the real rate of interest is so high. Sun tries to enforce the agreement. Bora tells the court that the agreement is actually usurious because of the back-dating arrangement. But Sun says the parol evidence rule prevents the court from considering such prior statements to contradict the terms of final and complete writings like this one.

QUESTION OF LAW Does the parol evidence rule prevent Bora from presenting evidence of the prior statements of the parties showing that the loan agreement is actually usurious?

DECISION No. The parol evidence rule does not prevent Bora from presenting evidence of prior statements showing the agreement is usurious, because the rule does not apply to evidence offered to show contracts are invalid.

The parol evidence rule does not prevent the court from considering prior statements offered to show that a contract is invalid for reasons such as illegality--even if the writing is final and complete. In this case, Bora tried to present evidence of prior statements of the parties to show that the contract was actually illegal because it was a usurious (back-dated) loan agreement. The parol evidence rule does not prevent Bora from doing this. If the court believes the evidence, Sun will not be able to enforce the loan agreement beyond the maximum legal rate.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.3c contains further discussion about methods of disguising usurious loan agreements.

8.5 When a Court Cannot Interpret a Disputed Term in an Agreement, the Result Often Depends on Whether the Term Is Material

Sometimes a court cannot interpret a disputed part of an agreement, despite using all the rules of contract interpretation, such as those discussed in this Chapter. When a court is unable to decide the meaning of a term in a contract, there are basically two possible results:

(1) if the court is unable to interpret a material term, then the agreement is generally not enforceable;

OR (2) if the court is unable to interpret an immaterial term, then the agreement is often enforceable without that term.

The next Sections discuss these two possibilities.

8.5a When It Is Not Possible to Interpret a Material Term in an Agreement, the Agreement Is Generally Not Enforceable

If a court cannot determine the meaning of a material (important) term in an agreement, even with all the rules of interpretation, then that agreement is generally unenforceable. In fact, when an agreement has this problem, it is generally too indefinite and unclear to be enforced. The material terms of an agreement must be definite and reasonably clear for a court to enforce the agreement, as discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b. But when it is impossible to determine the meaning of an important term, then it is impossible for a court to know what to enforce!

Of course, when parties do not specify a material term in their contract, the court may be able to supply a reasonable term. This was discussed in Section 8.3j, which explained gap-fillers. But where the parties do say something about a material term in their agreement, but the court cannot interpret the term, the court cannot supply a reasonable term. This is because parties in this situation did not want a "reasonable" term--they wanted their own term. Unfortunately, they failed to state it clearly enough for it to be enforced. This was explained in Section 8.3j.

Sometimes it is easy to determine that a contract term is "material." For example, identity and quantity are always material terms in sale of goods contracts--in fact, they are essential. And price terms are material in most if not all kinds of contracts. Unfortunately, there is no complete list of material terms--and it would be difficult to make such a list. This is because what is material depends on the contract and the parties in each case. Some terms are material to particular parties even though they might not be material to other parties in a similar situation. So to decide what is material in each case, the court must look at all the evidence in that particular case. These issues were discussed in Chapter 2, Section 2.3b.

If the part of the agreement that cannot be interpreted is severable, then the court may be able to simply enforce the rest of the agreement without the part it cannot interpret. Severability of parts of agreements was already discussed in Chapter 5 ("Legality"), Section 5.5b, and Chapter 7 ("Other Contract Formation Problems"), Section 7.7c. Severance basically involves dividing a defective agreement into corresponding sets of performances and enforcing the part that is not defective, if that is possible.

But where a term is material, it is often very difficult to sever it and leave an enforceable agreement. For example, there is generally no way to sever a description of the subject matter of the agreement, or the total price, because the whole agreement usually depends on those terms.

Of course, severance may still be possible in a few situations where material terms cannot be enforced. For example, in Case Study 137, suppose the lorry driver Vorn had made a contract to haul two different kinds of wood, with separate prices for each kind. Suppose there was no legality problem. Instead, one of the types of wood was not described clearly enough for a court to interpret it. In that case, the court might be able to sever the unclear part of the contract and enforce the rest.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance"), Section 2.3b contains further discussion about the requirement that material terms stated in contracts be definite and reasonably clear; Chapter 5 ("Legality"), Section 5.5b, Chapter 7 ("Other Contract Formation Problems"), Section 7.7c, and Chapter 10 ("Remedies"), Section 10.7c discuss severance of contract terms.

*** ***CASE STUDY 194***

FACTS The facts are the same as in Case Study 180. In that case, Pin Vipheak and Tung Yun signed an agreement for the sale of 200 hectares of land. But the agreement was inconsistent about the total price: one part of the contract said it was $100,000, and another part said it was $90,000. And the court found no way to resolve this conflict.

QUESTION OF LAW Can this agreement be enforced?

DECISION No. This agreement cannot be enforced because there is no way to interpret a material term: the price of the land.

Where a court cannot interpret a material term in an agreement, the agreement generally cannot be enforced. What is material depends on all the circumstances of the case.

In this case, Pin Vipheak and Tung Yun put two different total prices in their agreement for the sale of the land: $100,000 and $90,000. The court cannot resolve this inconsistency. As in many agreements, the price here is

a material term. And there is no way to sever this term--it is too central to the agreement. So the agreement cannot be enforced.

Another way to analyze situations like this is to say that the parties have made a bilateral mistake about the meaning of a material part of their agreement, and neither party has reason to know of the understanding of the other party. Mistakes like this are so serious that the court cannot fairly enforce the agreement, as discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.3a. So such agreements are void. For example, in Case Study 154, there was a bilateral mistake about the identity of the subject matter--a ship called the Eternal--that was so serious the court could not enforce the agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.3a contains further discussion about how courts respond to bilateral mistakes about the meaning of material terms.

8.5b When It Is Not Possible to Interpret an Immaterial Term in an Agreement, the Agreement Is Often Enforceable without That Term

If a court cannot determine the meaning of an immaterial (unimportant) term in an agreement, then the agreement is often enforceable without the immaterial term. In this situation, the agreement may still be sufficiently definite to be enforced, because the material terms are definite and reasonably clear, under the standards discussed in Chapter 2, Section 2.3b.

In particular, in these situations, the court may be able to sever the disputed term, as long as it can do so and still leave an agreement the law can enforce. Severance basically involves dividing a defective agreement into corresponding sets of performances and enforcing the part that is not defective, if that is possible. Severance was discussed in Section 8.5a above, and in Chapter 5, Section 5.5b, and Chapter 7, Section 7.7c.

For example, suppose the land sale contract in Case Study 194 was consistent about the price, but contained a provision requiring the seller to provide the buyer with "an extra key for the second story" of a house located on the property. This would probably be an immaterial term. Suppose there were actually many different door locks on the second story of the house, and the court was unable to interpret the "extra key" term. In that situation, the court might be able to simply sever the term and enforce the agreement without it. This is because it seems likely that the court would find a reasonable way to divide the agreement into corresponding performances without the "extra key" term--possibly by throwing the term away.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.3b contains further discussion of the requirement that offers be definite and reasonably clear; and Chapter 5 ("Legality"),

Section 5.5b, Chapter 7 ("Other Contract Formation Problems"), Section 7.7c, and Chapter 10 (“Remedies”), Section 10.7c discuss severance of contract terms.

8.6 Interpretation of Contracts in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the current Cambodian Contract Law (Decree #38D (1988)) and the civil law tradition appear to be generally compatible with the approach to contract interpretation discussed in this Chapter, except that there does not appear to be anything directly comparable to the parol evidence rule in these traditions.

******* ***CAMBODIAN LAW PERSPECTIVE:*** The approach of the current Contract Law of Cambodia (Decree #38D (1988)) seems basically compatible with the approach to interpretation of contracts discussed in this Chapter. However, there is no indication that courts applying Decree #38D would use a rule comparable to the parol evidence rule.

Basic Provisions

Article 23 of Decree #38D provides that if a “contract is not clear in meaning, that contract shall be interpreted according to the common practice or custom of the place where the contract has been made, but the interpretation shall not conflict with the provisions of this law.” Article 23 also states that if “there is any ambiguity, the contract shall be interpreted in favor of the debtor party.” Under Article 30, each party to a contract is a “debtor regarding the obligations to be executed.”

These provisions seem broadly consistent with the rules discussed in this Chapter. Article 23 appears to say that if a contract is not clear in meaning, the court should apply a general objective standard: the common practice or custom where the contract was made. This standard seems to stress what we have called the “usage of trade,” and may also include other objective sources of meaning, such as dictionaries and other accepted reference works. In fact, it seems possible that it could include a wide range of interpretation rules, since those might be described as part of the “common practice or custom” within a jurisdiction.

The provision about “ambiguity” requires that courts interpret ambiguities against the creditor party, meaning the party who is to receive the performance described in the ambiguous provision. This may be somewhat comparable to the “interpretation against the drafter” rules discussed in this Chapter, except that it would be more like "interpretation against the party receiving performance."

Implied Terms

Decree #38D contains a number of provisions that basically seem to require courts to supply terms to parties' contracts. Some of these are discussed below.

Article 2 says that parties to contracts shall "collaborate in an atmosphere of good conscience," and Article 22 requires that a contract "shall be executed honestly," among other things. These provisions may impose a requirement comparable to the "good faith" standard discussed in this Chapter.

Decree #38D also states that a number of fairly specific terms will be considered part of agreements, in certain situations. For example, Article 32 says that the execution of the contract shall occur at the "residence of the debtor," unless the contract has said otherwise. Article 33 basically says that if there is no specific time within which to execute the contract, the debtor can "pay or provide at any time," and the creditor can request payment at any time.

Chapter 2 of Decree #38D, which discusses particular kinds of contracts, contains a number of terms that must be considered part of these specific kinds of contracts, in certain situations. For example, Article 73 states that if no fee is specified in an enterprise contract, the court must determine a fee "according to the customary fees at the work place." In addition, Article 110 appears to state that where a lease has no specific duration, a party must give between one and two months notice to the other party in order to terminate the lease.

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to interpretation of contracts appears to be generally compatible with the one discussed in this Chapter, except that civil law jurisdictions do not appear to apply any rule directly comparable to the parol evidence rule. Of course, the exact rules about contract interpretation vary in different jurisdictions, so it is important to check the relevant local law.

It appears that at least some civil law jurisdictions emphasize the subjective approach to contract interpretation more than the objective approach. For example, in France, it seems that courts are supposed to look for the subjective meaning of disputed terms first. This approach appears broadly comparable to the approach discussed in this Chapter.

It seems that many civil law jurisdictions also apply a rule of interpretation that is comparable to the trade usage rule discussed in this Chapter. For example, in France, ambiguous terms are to be interpreted according to local usage and customs.

Some civil law jurisdictions may also apply rules comparable to the rules we have discussed requiring that courts interpret contracts against drafters. For example, it appears that German law regulates standard form contracts, which may often be basically adhesion contracts, and prevents merchants from disclaiming all liability for harm caused by their products. And in France, it appears that courts are also required to interpret contracts against the drafter, particularly in the case of adhesion contracts.

In addition, some civil law jurisdictions appear to apply ideas comparable to what we have called the duty of good faith. And they may actually apply those ideas more broadly than many common law jurisdictions. For example, German law appears to say that parties have a duty of good faith in their contract dealings, and to apply this duty at the negotiation stage, which does not generally occur in common law jurisdictions. And in France, the law says that parties have a duty of good faith in the negotiation and performance of contracts.

Finally, there does not appear to be any rule directly comparable to the parol evidence rule in civil law jurisdictions. However, it appears that many civil law jurisdictions generally limit the use of oral evidence in contract disputes more than common law jurisdictions do. Such civil law jurisdictions apparently try to resolve contract disputes primarily on the basis of documentary evidence.

8.7 Questions for Review

CHAPTER 8 -- QUESTIONS FOR REVIEW

1. Why is contract interpretation important?

2. When does contract interpretation occur?

3. What is an important limit on courts' preference to interpret contracts so that they are valid and reasonable?

4. What is the difference between a subjective interpretation and an objective interpretation?

5. What basic approach do many jurisdictions take with regard to subjective and objective interpretations of disputed contract terms?

6. Give examples to illustrate the rule of interpretation that courts must consider the whole contract.

7. In interpreting contracts, how do courts respond to inconsistencies between terms?

8. Give examples of types of terms courts may value more highly than others.

9. What is the plain meaning rule?

10. How can the main purposes of the parties affect the interpretation of a contract?

11. What is the course of performance and what effect does it have on contract interpretation?

12. What is the course of dealing and what effect does it have on contract interpretation?

13. What are trade usages and what effect do they have on contract interpretation?

14. When are disputed terms interpreted against the drafter?

15. When can courts interpret contracts to contain terms the parties omitted?

16. What is the duty of good faith and fair dealing?

17. What are "gap-fillers?" Give examples.

18. What kinds of evidence may courts use to interpret contracts?

19. What is the parol evidence rule?

20. When does the parol evidence rule not apply?

21. What happens when a court cannot interpret a disputed term?

22. Is the Cambodian approach to interpretation of contracts basically compatible with the approach discussed in this Chapter?

23. Is the civil law approach to interpretation of contracts basically compatible with the approach discussed in this Chapter?

CHAPTER NINE

PERFORMANCE AND DISCHARGE OF DUTIES

9.1 Introduction

Parties to contracts may ask courts to resolve disputes about whether contracts are enforceable, and what the contracts mean. This text has already examined how courts decide whether contracts are enforceable (in Chapters 2-7) and what contracts mean (in Chapter 8).

However, once courts make these decisions about contracts, they must often also decide whether parties have actually performed the contracts properly, and whether any contract duties remain to be performed. This Chapter discusses some of the important rules courts use to make these decisions about contract performance. Then, Chapter 10 ("Remedies") will discuss remedies courts may choose to order if they decide that a contract has not been performed properly.

In free market jurisdictions, a great deal of business, government and other activity is based on contracts. In general, this system works well, without any involvement by the courts. The system basically regulates itself. The reason is that most parties to contracts perform the contracts with no problems. They do not need or want to get involved in litigation, which can be expensive, time-consuming, and unpleasant.

Unfortunately, sometimes one or more parties to a contract are not satisfied with how a contract is performed, and there is a dispute. Such disputes can be difficult and complex--and so some of the rules about contract performance are also difficult and complex. As noted above, when parties have a dispute about contract performance, the dispute usually concerns whether contract duties have become due for performance, and whether those duties have ended or remain to be performed.

In general, contract duties end when they are discharged. This can occur through proper performance, or in a number of other ways. This idea is introduced in Section 9.2 below.

Whether contract duties have become due for performance and whether they have been discharged may depend on the nature of performances required by the contract. Specifically, the status of contract duties may depend on whether any conditions to performance have been fulfilled or excused, and whether promises in the contract have been performed when they were due to be performed. Conditions are events which must occur or be excused in order for a duty of performance to become due or terminate. Conditions may be classified by when they occur (precedent, subsequent, or concurrent), and by how they are created (express, implied-in-fact, or implied-in-law). Promises are basically statements that a party will perform a duty when that performance is due. This is explained in Section 9.3, below.

In general, contract duties become due and must be performed when any condition on which they depend is fulfilled or excused. If such a condition is not fulfilled or excused, then the duty of performance depending on the condition never becomes due--so the party with that duty need not perform it! A condition is fulfilled if by its occurrence; by complete performance; or in the case of implied-in-law conditions, by substantial performance. A condition may be excused in a number of ways, including anticipatory repudiation; prospective inability or unwillingness to perform; failure or occurrence of a prior condition; improper rejection of a tender of performance; wrongful prevention or hindrance of a tender of performance; waiver or estoppel; or impossibility of performance. The failure of a condition may not affect the whole contract if it is severable. And conditions of approval by parties or non-parties are subject to a number of limits. These difficult but important ideas are discussed in Section 9.4.

The above rules about performance may work a little differently in particular situations. Section 9.5 examines some special rules about performance of construction contracts and sale of goods contracts. It also explains how the duty of good faith and fair dealing applies to contract performance in many jurisdictions.

When a contract duty is due to be performed, the duty may be discharged in a number of ways. It may be discharged by performance as promised in the contract; by a breach (failure to perform properly), anticipatory repudiation, or improper rejection of a tender by the other party to the contract; or by other events directly related to the performance of the contract, such as the occurrence of a condition subsequent or avoidance of a voidable contract. Discharge of duties in these ways is discussed in Section 9.6.

In addition, even if contract duties are not discharged in the above ways, the duties may be discharged by a later agreement or statement of the parties themselves. Important examples include mutual rescissions, releases, substitute contracts, accords and satisfactions, novations, and accounts stated. These possibilities are discussed in Section 9.7.

Finally, duties may be discharged by operation of law. That could occur through impossibility or impracticability of performance; frustration of purpose; bankruptcy proceedings; a final court judgment or arbitration award; or the passing of the time set by a statute of limitations. This is discussed in Section 9.8.

The analysis of contract performance and discharge of duties in this Chapter is based mainly on the common law tradition. It appears that the practical effects of the civil law approach to contract performance are generally compatible with the approach discussed in this Chapter, although the civil law approach is expressed somewhat differently. Of course, as always, it is important to check the specific law relevant to any contract in a particular case.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4h contains a more concise discussion of performance and discharge of duties.

9.2 Duties to Perform under Contracts End When the Duties Are Discharged

Most enforceable contracts require each party to do something. That is, each party to a contract generally has duties to perform under that contract. In fact, the reason a party makes a contract is usually to make sure that the other party will perform the duties the first party wants to be performed! So when courts try to resolve disputes about the performance of contracts, perhaps the most basic questions they ask are whether these duties of performance of the parties have become due, and whether the duties have ended, or been discharged.

*** **DEFINITION:** A **discharge** is basically an ending of a duty to perform under a contract.

For example, if a party properly performs his obligation to pay a certain amount for bananas under a contract for the sale of bananas, courts say that that party's duty to pay for the bananas has been discharged.

Usually, duties to perform under contracts are discharged by proper performance of the parties. But unfortunately, as noted above, disputes sometimes occur about whether parties really have performed their duties properly according to the contract. And duties may also be discharged in ways other than proper performance.

In order to understand the status of duties under a contract, courts often must first examine whether those duties are actually due to be performed. Courts then ask whether the contract duties have been discharged.

If a contract duty is due to be performed but has not been discharged, and a party complains to a court, the court may choose to order one of the remedies discussed in Chapter 10 ("Remedies").

*** ***WHY IS THIS IMPORTANT?*** Why do courts consider whether duties have become due, and whether they have been discharged, in resolving disputes about contract performance?

Courts consider these questions in order to analyze the current status of the parties' performance of the contract. The final goal of every contract is that all obligations under the contract be ended through full, proper performance by all parties. Obviously, the reason parties make contracts is to achieve full performance, and gain the benefits of that performance. Courts want to see if that has occurred.

To find out if it has occurred, courts ask whether the obligations under the contract have become due, and whether they have ended for some reason. If duties under the contract have not become due, courts must decide if any remedy is appropriate. If the duties under the contract are due but have not been discharged, then the court must generally decide on an appropriate remedy. But if the obligations under the contract have been discharged, then there may be no need for the court to go further and decide on appropriate remedies to resolve the dispute between the parties. In addition, in each of these situations, the potential remedies may differ. So when courts ask whether contract duties have become due and whether they have been discharged, it is really a way of analyzing the performance of the contract, in order to help the court decide how it should resolve the dispute of the parties.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains further discussion of remedies courts may choose when parties ask the courts to resolve contract disputes.

9.3 Whether Contract Duties Have Become Due, and Whether They Have Been Discharged, May Depend on the Nature of the Performances the Contract Requires

When courts consider the performance of a contract, they ask whether the duties in the contract have become due, and whether those duties have been discharged, as noted above. However, in order to learn the answers to those questions, courts must first understand the nature of the performances required by the contract. Specifically, in order to determine what the contract requires, courts must analyze conditions and promises in the contract.

9.3a Conditions vs. Promises: Conditions Are Events Which Must Occur or Be Excused for a Duty of Performance to Become Due or Terminate, And Promises Are Statements That a Party Will Perform a Duty When That Performance Is Due

In analyzing contract performance, it is very important to understand the difference between conditions and promises. All contracts contain promises, which create legal duties. Many contracts also contain conditions, which affect whether those legal duties are due to be performed or not.

*** **DEFINITION:** A **promise** is basically a statement that a party will perform a contract duty when that performance is due.

*** **DEFINITION:** A **condition** is a particular future event which is not certain to occur, but which must occur or be excused for a contract duty to become due for performance, or for that duty to be terminated if the duty is already due.

So the basic difference between promises and conditions is that promises are statements that create legal duties, but conditions are events that affect whether parties are actually required to perform duties or not! Since the distinction between promises and conditions is one of the most important in contract law, this text will explain it in more detail.

Promises are statements by parties to a contract that they will actually do something in the future. That is, promises create legal duties to perform under contracts. In common law jurisdictions, unilateral contracts are created by an exchange of a promise for an act, and bilateral contracts are created by an exchange of a promise for a promise, as explained in previous Chapters.

For example, if Him promises to pay Lim 1,000 riels in exchange for Lim's promise to climb a certain tree, the parties' promises have created their legal duties: Him's promise has created a legal duty for him to pay 1,000 riels, and Lim's promise has created a legal duty for her to climb the tree.

If a party fails to perform according to his promise when that performance is due, he has breached the contract. That means the other party has the right to ask a court to award him an appropriate remedy for the damage caused by the breach, such as money damages. In the example above, if Him failed to pay when his duty to pay was due, that would breach the contract, and so Lim could ask the court for a remedy. Likewise, if Lim failed to climb the tree when that duty to perform was due, that would be a breach, and Him could ask the court for a remedy. Breach of contract will be further discussed in Sections 9.4 and 9.6, below.

Conditions are events that must occur before contract duties actually become due or are terminated. In other words, conditions affect whether contract duties are actually due to be performed or not.

For example, suppose Him and Lim made the same agreement described above, except the agreement said Lim was required to climb the tree only if Ponlee returned from Kompong Speu by Friday. In that case, there would still be two promises (and legal duties) in the contract: Him's promise (and duty) to pay and Lim's promise (and duty) to climb. But Lim's promise (duty) in this situation is subject to a condition: her duty to climb does not become due for performance unless Ponlee returns from Kompong Speu by Friday. That means that if Ponlee does not return from Kompong Speu by Friday, Lim's duty to climb the tree never becomes due for performance! In that case, Lim will not be legally required to climb the tree. This is a condition, because it is an event that is not certain to occur--Ponlee may not return by Friday--but that must occur for Lim's duty to climb to become due. A contract might also say that Lim must climb the tree unless Ponlee returns from Kompong Speu by Friday. In other words, it might say that Lim's duty to climb is due unless Ponlee returns by Friday. This is also a condition, but one whose occurrence terminates Lim's duty to climb the tree. The different types of conditions will be discussed in more detail in Sections 9.3b and 9.3c, below.

On the other hand, events that are certain to occur cannot be conditions. For example, if the contract simply said that Lim was not required to climb the tree until Friday, that would not be a condition, because Friday is certain to occur. Lim's duty is certain to become due (unless it is discharged before Friday by one of the special circumstances discussed in Sections 9.6-9.8 below). So courts say the duty is not conditional.

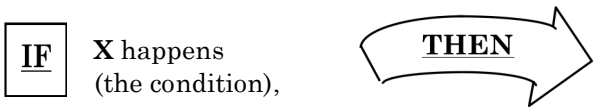
Because conditions are events that are not certain to occur, there is always some risk that they will not occur. This risk may make it appear that the duty which is subject to the condition is really illusory, since it may never be due for performance. And of course, common law jurisdictions say that illusory promises are not consideration, as discussed in Chapter 3 ("Consideration"), Section 3.5d. However, most duties subject to conditions are not illusory, because the party with the duty is taking the risk that the duty will become due! This risk is a real legal detriment. If a condition occurs and causes the duty to become due, then the party with the duty cannot avoid it. The only way such a duty might be illusory would be if the condition on which the duty depended was completely within the control of the party who had the duty. For example, if Lim's duty to climb a tree was conditioned on her own return from Kompong Speu, it seems likely that would be viewed as an illusory promise (and duty) in common law jurisdictions. This is because Lim would probably have complete control over whether she returned from Kompong Speu or not.

Likewise, contracts with conditions may seem as if they do not have a real agreement of the parties, since it is possible that one or both parties will never be required to perform, because of the condition. However, in contracts with conditions, there is nothing conditional about the parties' real agreement: the parties have unconditionally agreed to the contract itself. And even though there is always a risk that the contract will not be fully performed--

whether because of conditions or some other reason--both parties have definitely agreed to take that risk. So the agreement itself is definite and unconditional. It is only some part of the performance of the agreement that is subject to a condition. Conditions were also discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Sections 2.6b and 2.10b.

In the discussion of conditions in Chapter 2, Section 2.6b explained how conditions can terminate an offer, and Section 2.10b explained how acceptances must be unconditional in order to create bilateral contracts. As discussed in those Sections, one way to think about conditions is as an "if-then" relationship between events: if X happens, then Y will happen. In analyzing the performance of contracts, conditions basically mean that if X (a condition) happens, then Y (a legal duty) will become due for performance, or terminate if it is already due. And of course, if X (a condition) does not happen, then Y (a legal duty) will not be affected. This is illustrated in the chart below.

Illustration: Basic Formula for a Condition to Affect a Contract Duty



This also means that:

If X does not happen, **then** Y will not happen. That is, the occurrence of Y actually depends on the occurrence of X.

Sometimes a condition is an event that is not one of the duties under the contract, and the failure of that condition to occur will not breach the contract. For instance, in the tree climbing examples above, the conditions were simply related to the return of Ponlee from Kompong Speu, which was not a duty under the contract. That is, the contract did not require Ponlee to return from Kompong Speu--Ponlee never promised to do so--and her failure to return would not breach the contract. In fact, Ponlee was not even a party to the contract! And in general, a condition can be an event that really does not relate to the parties, such as whether it rains on a certain day, or whether a certain event happens in a particular financial market. Obviously, the failure of such conditions would not breach a contract either.

However, sometimes one part of the contract can be both a promise and a condition! In other words, sometimes the performance of a promise of a party--the performance of a legal duty--is also a condition to the performance of a party's promise. In that case, the failure of the condition to occur might also be a failure of a party to perform a legal duty under the contract. And as noted above, a failure to perform a legal duty when it is due is a breach of the contract.

Often the performance promised by one party is actually a condition to the performance of the other party. If the first party failed to provide such a performance when it was due, it would mean that the other party would not be required to provide the performance that depended on the condition occurring. Of course, the first party's failure to perform would also breach the contract, and the other party could ask a court for a remedy, such as money damages. For example, suppose a real estate sale contract says that the seller will have no duty to provide the property unless the buyer first pays the entire sale price in cash. In that case, the buyer's statement that she will pay in cash is a promise, and the buyer's performance of that promise is a condition to the seller's duty to provide the property. If the buyer fails to pay the money when it is due, the seller's duty to provide the property will not become due. And the buyer's failure to pay will also breach the contract.

And it is also possible that one part of a contract can contain a promise of one party and a condition to the performance of that same party. In the real estate example above, this might occur if the contract said that the buyer's duty to pay was conditioned on the buyer getting a mortgage loan at a certain interest rate, which the buyer might promise to use reasonable efforts to obtain. In that case, the performance of the buyer's promise to try to get the loan would affect the buyer's own duty to pay for the property! This is because getting the loan would actually be a condition to the buyer's own duty to pay. If the buyer tried but failed to get the loan--and so the condition failed to occur--then the buyer's own duty to pay would not become due, and of course the seller's duty to provide the property would not become due.

This contract might seem to contain an illusory promise, as discussed above, since the buyer's duty to pay was conditioned on the buyer's own attempt to get the loan. However, the contract also required the buyer to use reasonable efforts to get the loan, and if the buyer failed to do that, he would breach the contract. So the buyer did not have complete control over whether the condition occurred, and the buyer's duty to pay for the property was not illusory. Of course, if the buyer's duty to pay was simply conditioned on the buyer obtaining the loan--with no promise to use reasonable efforts--that would probably be an illusory promise, since the buyer would not really be obligated to do anything.

Obviously, the relationship between promises and conditions can be somewhat confusing. The following Case Study illustrates the possibility that one part of a contract can be both a promise and a condition.

******* ***CASE STUDY 195***

FACTS The farmers Peo and Rhet agree that Peo will harvest Rhet's red pepper crop for 100,000 riels "provided that Rhet will have no duty to pay Peo unless the crop is completely harvested." Peo begins to harvest the crop.

Soon after Peo begins to harvest the crop, he asks Rhet to pay him the 100,000 riels immediately. Peo says that it will take him a few more weeks to complete the harvest, but he needs the money sooner than that. But Rhet says he has no duty to pay anything until Peo has completely harvested the crop. Peo says he will do no more work unless Rhet pays him the money now. The parties ask the court to resolve their dispute.

QUESTION OF LAW Can Peo get his money under this contract before he completes the harvest?

DECISION No. Rhet has no obligation to pay Peo the 100,000 riels yet, because Rhet has no duty to pay under the contract until the condition of Peo completing the harvest occurs.

When a contract says that a particular legal duty is not due for performance until a particular condition occurs, the party who has the duty need not perform the duty until that condition occurs. And if the condition does not occur, then the legal duty does not become due. In this case, the parties' contract contained two promises: Peo promised to harvest a red pepper crop, and Rhet promised to pay Peo 100,000 riels. But the contract also contained a condition: it said Rhet had no duty to pay--no duty to perform the legal duty his promise created--unless Peo completely harvested the crop. Peo demanded the money before he had completed the harvest. But under the contract, Rhet had no duty to pay until Peo completed the harvest. So a court will not order Rhet to pay Peo until Peo completes the harvest. Condition has not occurred = duty of performance is not due.

If Peo did not continue to harvest the crop, then Rhet's duty to pay him would never become due. In addition, such a failure to continue would be a breach of the contract by Peo--a failure to obey his promise to harvest the crop--and Rhet could also ask the court for a remedy to compensate him for Peo's breach. Of course, Peo might be able to persuade the court to award him restitution of the reasonable value of the work he had completed for Rhet, under the doctrine of quasi-contract, minus any damages Peo's breach caused to Rhet. This will be discussed further in Section 9.4, below.

*** ***WHY IS THIS IMPORTANT?*** Why does it matter whether a part of a contract is subject to a condition or not?

Whether a part of a contract is subject to a condition or not can make a big difference in how the parties must perform under the contract. When parties promise to do something under a contract, they have a legal duty to perform that promise. If they fail to perform when their duty is due, then they have breached the contract, and the other party can ask the court to award an appropriate remedy, such as money damages.

But if some performance under the contract is also subject to a condition, that means the performance will never even become due unless

the condition occurs! So making a performance subject to a condition provides another option--and often a more powerful option--for parties who want to make sure that a certain event occurs as part of their contract.

The practical effect of these rules is that if parties want the failure of a performance to result in a party being able to ask a court for a remedy like money damages, then the parties should make sure that performance is contained in a promise in the contract. But if the parties also want the failure of one performance (or any other event) to result in a party simply not being required to provide his performance, then the parties should make sure that latter performance is subject to a condition that will achieve the result the parties want.

For example, in Case Study 195, Rhet wanted the right to ask a court for a remedy if Peo failed to harvest the red pepper crop. So Rhet made sure that Peo's promise to harvest the crop was part of the contract. But Rhet wanted another alternative which really gave him added power in the contract, and made it more likely that Peo would finish the job. To achieve this goal, Rhet put a condition in the contract. The contract said that Rhet had no duty to pay unless Peo completed the harvest. This condition meant that Peo had no right to any money under the contract until he completely finished the harvest, and that if Peo failed to do that--meaning the required condition did not occur--then Rhet had no contract duty to pay him at all! By contrast, if Rhet was required to pay before Peo finished the harvest, then Rhet would be taking a risk that Peo might not complete it--since Peo could simply go away after receiving the money. Then Rhet would have to go to the trouble and expense of trying to get compensation for this breach of the contract. And because of the many practical difficulties in litigation, it is possible Rhet would unable to recover anything at all from Peo! Of course, as noted above, even if Peo stopped work and Rhet had no contract duty to pay him, courts might award Peo restitution for work he did for Rhet, if that was necessary to avoid injustice. But the condition in this contract meant Rhet had no duty under the contract itself to pay Peo unless Peo completed the harvest.

Obviously, a condition can be a very powerful part of any contract. So parties who make contracts should always consider whether they do--or do not--want conditions in their contracts.

The following chart shows some of the differences between promises and conditions.



Illustration: Comparison: Promises and Conditions

	Promise	Condition
1. What is it?	A statement that a party will perform a contract duty when the duty is due	An event that makes a duty to perform become due or terminate
2. What is its legal effect?	Creates a legal duty to perform	Occurrence makes a legal duty become due or terminate
3. What happens if the duty is not performed when due, or the condition fails?	Breach of contract, and court may award money damages or other remedy	A legal duty does not become due, or remains due if it is already due
4. Key Differences	(a) is a statement that creates a contract duty	(a) is an event whose occurrence makes a contract duty become due or terminate
	(b) failure to be performed when due is breach of contract	(b) failure to occur may affect whether contract duty is due or not

Sometimes it can be difficult to tell whether part of a contract actually is a condition or not. One reason for this is that not all conditions are expressly stated in the contract, as the conditions in Case Study 195 and the other examples above were. In fact, conditions can be express or implied. And as noted above, they can make the performance of a legal duty become due, or terminate that duty. Unfortunately, this can sometimes make it difficult to tell whether a part of a contract really is a condition or not! So Sections 9.3b and 9.3c below will look more closely at the different types of conditions that may occur in contracts.

In addition, the law says that conditions may be excused in particular situations where it would be unfair or inappropriate to expect them to occur. When a condition is excused, the duty that depends on that condition becomes due--even though the condition has not occurred! So the effect is the same as if the condition had actually occurred. The various ways conditions may be excused are discussed in detail in Section 9.4, below.

The result when a condition fails to occur or be excused is that the duty subject to the condition does not become due, as noted above. Obviously, this can result in unjust enrichment, such as in the situation where a party provided some benefit to the other party but failed to fulfill a condition on which the other party's duty to perform depended. For example, this might occur in Case Study 195 if Peo performed some of the red pepper harvest and then stopped. In these situations, the party who has provided some benefit may be able to get restitution of what he has provided to the other party,

under the doctrine of quasi-contract. Of course, if the condition failed because one party failed to perform, the amount such a party would recover would be reduced by any damage caused to the "innocent" party because of the other party's failure to fulfill the condition. In addition, such restitution may not provide a party with as much as that party would have received under the contract if he had actually fulfilled the condition. This will be discussed further in Sections 9.3c, 9.4, and 9.5, below.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 explained quasi-contracts; Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6b discussed how conditions can terminate contract offers, and Section 2.10b explained how acceptances must be unconditional to create bilateral contracts; Chapter 3 ("Consideration"), Section 3.5d discussed how illusory promises are not generally consideration in common law jurisdictions; and Chapter 10 ("Remedies") contains further discussion of what courts do when parties fail to perform contracts properly.

9.3b Conditions Classified by When They May Occur: Precedent, Subsequent and Concurrent

One way courts classify conditions is by when they may occur in relation to the performance of the contract duties that the conditions affect. When conditions are classified this way, there are three types:

(1) conditions precedent,

(2) conditions subsequent,

and (3) conditions concurrent.

Although the names of these three types may sound difficult, it may be helpful to keep in mind that there really is not much practical difference among the three types: all three simply affect whether a contract duty is due or not. The reason courts make these distinctions is to help them analyze when contract duties are due, as explained below.

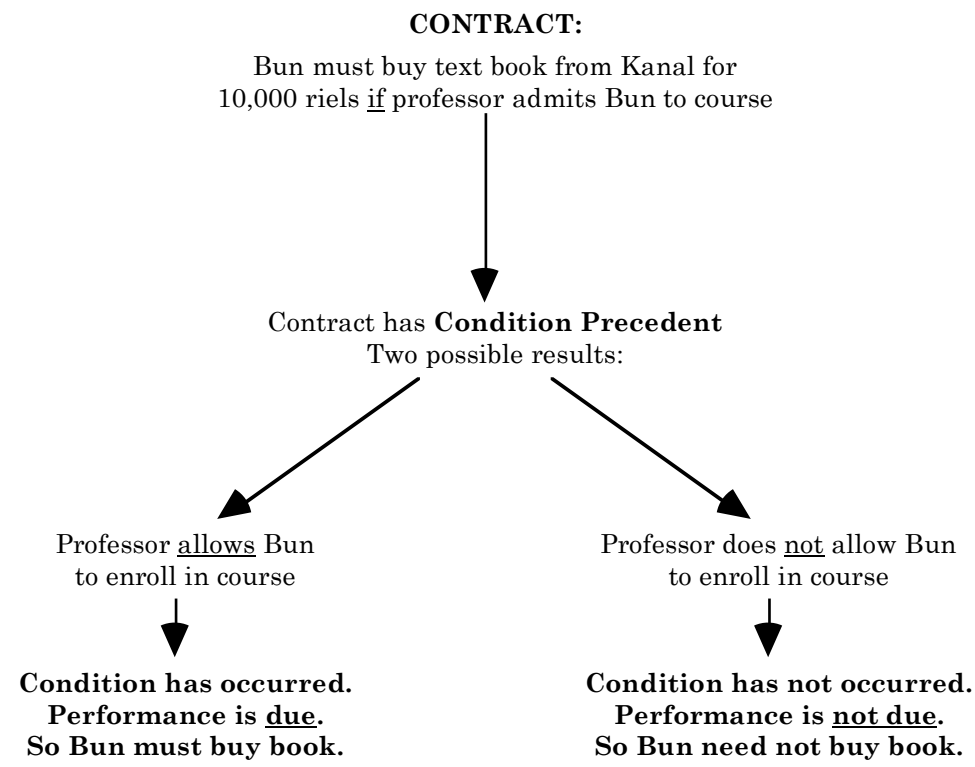
(1) Conditions Precedent Are Those That Must Occur Before a Duty of Performance Becomes Due

Conditions precedent are those that must occur before the duty which depends on them becomes due for performance. That is, if the condition precedent does not occur first, the duty of performance does not become due! Most conditions appear to be some form of condition precedent.

For example, the condition in Case Study 195 was a condition precedent: the complete harvesting of the red pepper crop by Peo was a condition precedent to Rhet's duty to pay Peo for harvesting the crop. If Peo did not complete the harvest, then Rhet had no contract duty to pay. And in the tree climbing example in Section 9.3a above, where Lim had no duty to climb

unless Ponlee returned from Kompong Speu by Friday, Ponlee's return was a condition precedent to Lim's duty to climb. And if Bun agreed to buy Kanal's literature text book for 10,000 riels only if a professor allowed Bun to enroll in a particular literature course, Bun's admission to the course would be a condition precedent to Bun's own duty to buy the book. The following chart illustrates conditions precedent.

Illustration: Example of How Conditions Precedent Work

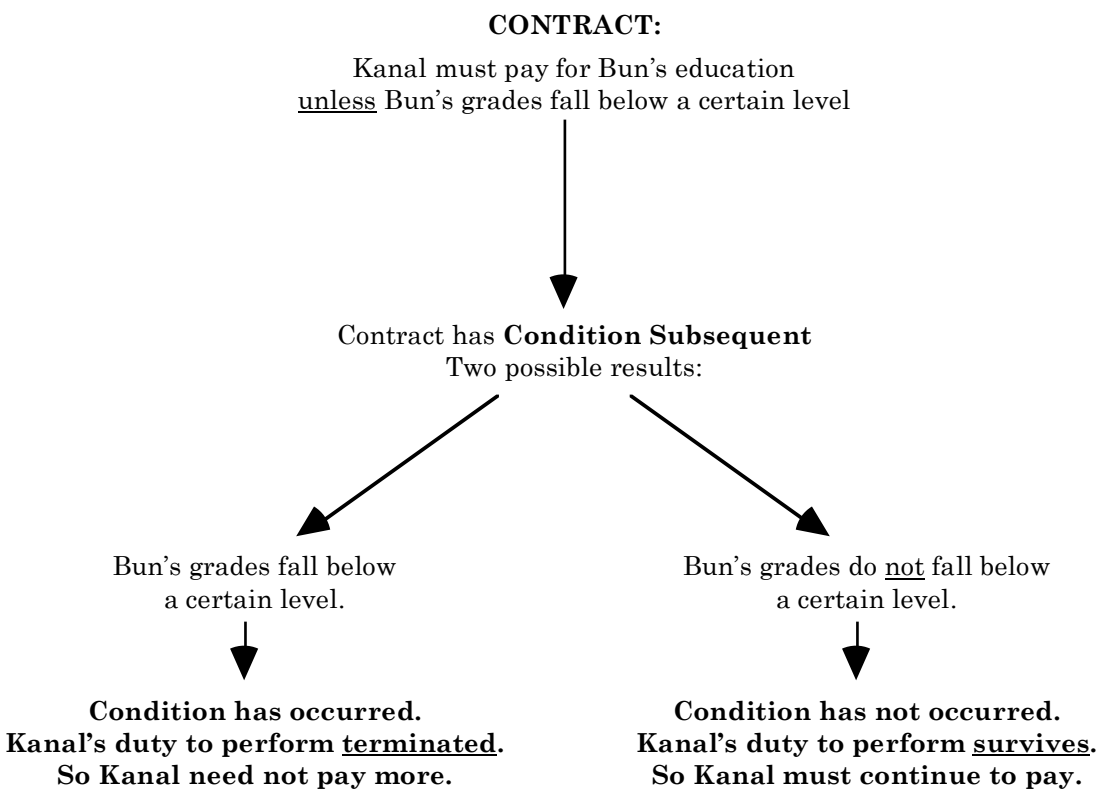


(2) Conditions Subsequent Are Those That Terminate a Duty of Performance That Is Already Due

Conditions subsequent are in a way the opposite of conditions precedent. Instead of causing a legal duty to become due for performance, conditions subsequent actually terminate a legal duty which is already due for performance.

For instance, suppose Bun and Kanal agreed that Bun would attend university, and that Kanal would pay for Bun's education unless Kanal's grades fell below a certain level. In that situation, there would be a condition subsequent: if Bun's grades fell below a certain level, then Kanal's duty to pay for Bun's education would terminate. The illustration below explains this possibility.

Illustration: Example of How Conditions Subsequent Work



Although conditions subsequent are in a way the opposite of conditions precedent, in practice there is generally no important difference between the two! One reason for this is that most conditions subsequent are basically conditions precedent that are simply stated in reverse. That is, most conditions subsequent are really just conditions precedent stated in a different way. For instance, in the university example above, where Kanal's duty will terminate if Bun's grades fall below a certain level, another way to describe the situation would be to say that Kanal's duty to pay will become due if Bun's grades remain at that level or above--which is really a condition precedent.

In fact, some authorities say that conditions like the one above are not "true" conditions subsequent, since they are really just conditions precedent stated in a different way. In other words, these authorities would say that the duty of Kanal in the example above is not due until the event described fails to occur--it is not due unless Bun keeps his grades at a certain level. So in a way it is really just a condition precedent!

These authorities say that "true" conditions subsequent--conditions that really terminate an existing duty, rather than merely seem to do so--are rare. One area in which they might occur is in insurance contracts. In such contracts, after a claim that was covered by the policy occurred, a policyholder might have only a certain amount of time to bring a lawsuit to enforce

that claim against the insurance company. In that situation, the insurer's duty to pay the covered claim would really be due already--but that duty would be terminated by the policyholder's failure to bring a lawsuit about it within a certain time. That would be a "true" condition subsequent.

(3) Conditions Concurrent Are Those That Must Occur Roughly Simultaneously in Order for Each Party's Duty to Perform to Become Due

Conditions concurrent exist where the performances of the contract duties of the parties can occur roughly simultaneously, and where each party's duty to perform is conditioned on the performance of a duty by the other party. In fact, the general rule about these conditions is that they exist whenever:

(1) the performances promised by the parties can be performed roughly simultaneously;

AND (2) the contract does not expressly require that one performance occur first.

When these requirements are met, courts imply that the performance of each party is a condition to the duty of the other party to perform. One important situation where this often happens is in sale of goods contracts. Courts imply such concurrent conditions even though the contract itself says nothing about which party must perform first! Such "implied-in-law" conditions will be discussed in detail in Section 9.3c, below. Of course, the parties could also choose to create concurrent conditions expressly in their contract.

Conditions concurrent can be:

(1) fulfilled by performance, or

(2) excused by a proper tender of performance.

A "tender" of performance basically means a party's offer to perform with the present ability to do so. For example, a seller's tender in a sale of goods contract might be delivering the goods to a buyer's place of business and offering the goods to the buyer. Where there are conditions concurrent, either proper performance or a proper tender will cause the other party's duty to become due. This means that each party can cause the other party's duty to become due merely by properly offering performance according to the contract, while giving some indication that the party has the ability to perform--even if the other party rejects that tender! Of course, the tender of performance must be proper in order to be effective. Tender of performance as an excuse of contract conditions will be discussed in more detail in Section 9.4g, below.

For instance, in the text book example above, suppose Bun and Kanal put no express conditions in their contract, but merely said Bun would buy Kanal's book for 10,000 riels. In that case, each party's duty to perform would be a condition concurrent to the other party's duty to perform--even though

there were no express conditions in the contract. In other words, Bun's payment of 10,000 riels to Kanal would be a condition whose occurrence would cause Kanal's duty to provide the book to become due. And Kanal's providing the book to Bun would be a condition whose occurrence would cause Bun's duty to pay to become due.

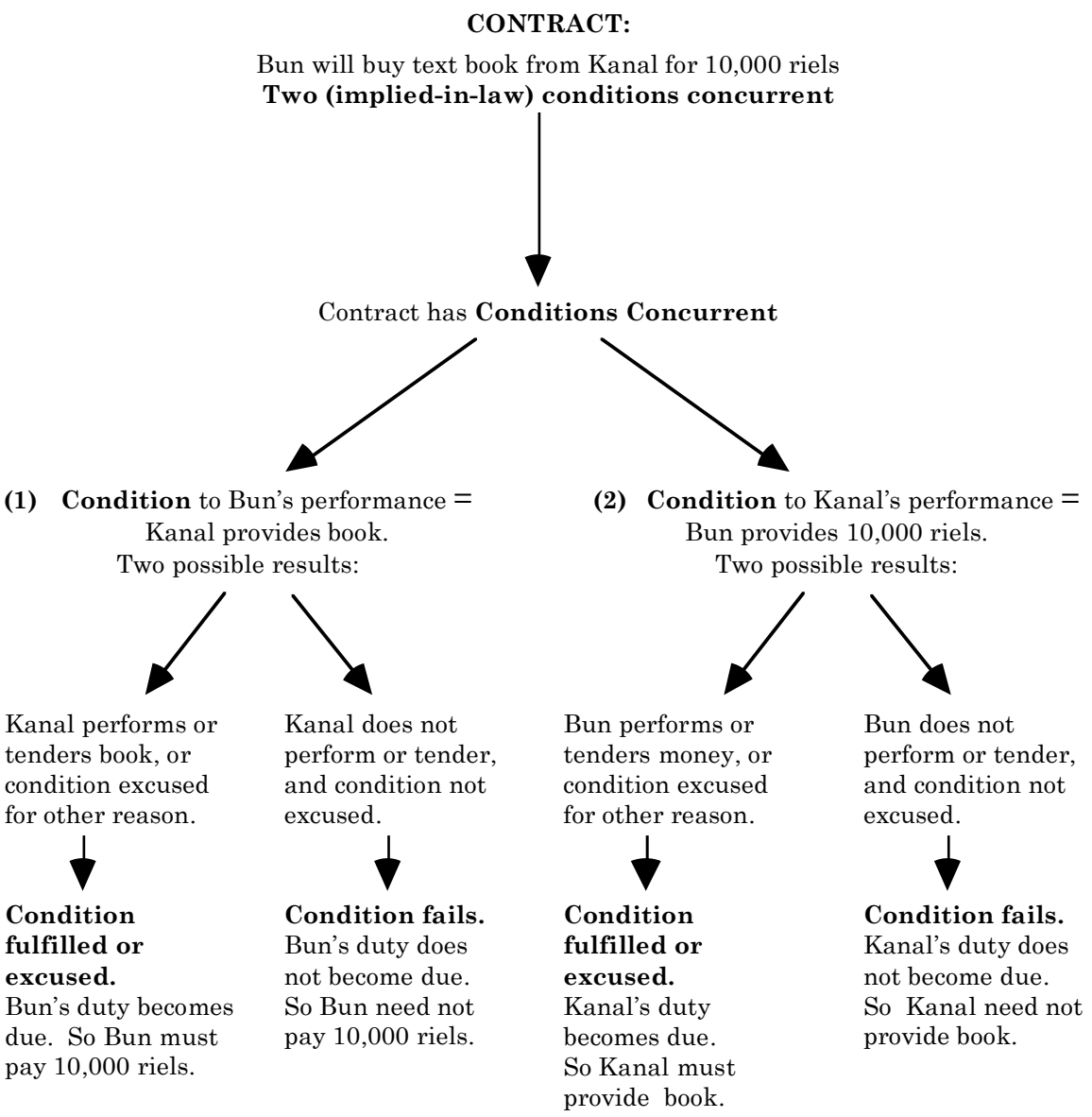
One result of concurrent conditions is that if both parties wait forever to perform or tender their performance, and the conditions are not excused for any other reason, then neither party's duty to perform his promise will ever be due! And of course, if neither party's duty to perform his promise is ever due, then there can be no breach of the contract. So a party who wishes to have such contracts performed generally must perform or tender his own performance in order to make the other's party's duty to perform become due.

Concurrent conditions are basically two conditions precedent that are linked to each other. As with conditions precedent, each condition concurrent must occur or be excused before a particular party's duty to perform becomes due. Of course, the event whose occurrence leads to each party's contract duties becoming due is the other party's performance! So although each party's duty to perform depends on the other party performing first, at least one party must perform or tender performance if he ever wants the contract to be executed (assuming the duty is not excused for some other reason).

Many contracts contain implied-in-law concurrent conditions. The reason is that there are many contracts in which the parties can perform their promises simultaneously and the contract does not require otherwise. Perhaps the most important examples are sale of goods contracts and land sale contracts. The illustration and Case Study below explain how concurrent conditions work.



Illustration: Example of How Conditions Concurrent Work



*** ***CASE STUDY 196***

FACTS Samath and Chhon signed an agreement which said that Samath agreed to buy Chhon's car for $5,000. The agreement said nothing about any conditions to the performance of either party. It did say that Chhon would deliver the car to Samath in a week.

A few days after the parties signed the agreement, Chhon phoned Samath and said that he would like to have the $5,000 before he delivered the car. Samath said she would give Chhon the money at the same time as he delivered the car. Chhon insisted on getting the money first. But Samath

did not trust Chhon completely. So she did not want to give him the money before she got the car, or at least saw that he was about to provide it to her.

QUESTION OF LAW Does Samath have a duty to pay the money to Chhon before the car is delivered to her under this contract?

DECISION No. Samath has no obligation to pay Chhon the $5,000 yet, because the parties' duties are concurrent conditions, and Samath generally will have no duty to pay until Chhon provides or tenders the car.

When contract duties can be performed roughly simultaneously and the contract does not provide otherwise, each party's duty to perform is concurrently conditioned on the other party's performance. In this case, Samath agreed to buy Chhon's car for $5,000, and the contract contained no express conditions. In this situation, the parties' performances can occur roughly simultaneously--since Samath and Chhon can exchange the money and the car at about the same time--and the contract does not expressly require that one performance occur first. So the performances of the parties' duties are concurrent conditions. That means that neither party's duty to perform is due until the other party performs (or tenders). Therefore, Samath's duty to perform by paying the $5,000 is not due until Chhon performs by providing the car (or tenders performance). Since Chhon has not done either of those things, Samath's duty to pay the money is not due yet. Condition has not occurred or been excused = duty of performance depending on the condition is not due yet.

9.3c Conditions Classified by How They Are Created: Express, Implied-in-Fact and Implied-in-Law

As noted above, conditions may be created in more than one way. Not all of them are expressly stated in the contract, as the pepper harvesting condition in Case Study 195 was. Some conditions are actually implied by the courts, as the concurrent conditions in the car sale contract in Case Study 196 were. In fact, when conditions are classified by how they are created, there are basically three different kinds of conditions:

(1) express conditions,

(2) implied-in-fact conditions, and

(3) implied-in-law conditions.

Each of these types of conditions is discussed below.

(1) Express Conditions Are Those Created by Words in the Contract

Express conditions are simply those created by the words of the contract itself. For instance, all of the conditions in the examples in Section 9.3a were express: the Him and Lim tree climbing examples, the real estate contract

examples, and the pepper harvesting contract in Case Study 195. In each of these cases, the parties put a particular condition in the words of their contract. The contracts actually said that a performance (such as a duty to climb a tree) would become due, or cease to be due, only if a particular condition occurred (such as a person's return from Kompong Speu).

In fact, the particular words the parties use in their contracts can be an important sign that the contract has an express condition. Examples of words parties often use to put express conditions in their contracts include "if," "on condition that," "subject to," and "provided that."

However, no particular words are required for an express condition to exist. What matters is that the words clearly show that the parties intended the condition to exist. For example, the parties can also create an express condition by saying that "the duty to pay will not be due unless Chheang first resigns from his job."

One very important aspect of express conditions is that courts generally require that they be completely and exactly fulfilled (or excused) in order for the duties which depend on them to become due. In other words, where an express condition exists, it is generally not enough that it be partly or even mostly fulfilled. In order for the duty subject to the condition to become due, the condition must be completely fulfilled (or excused). Otherwise, the duty is not due.

This can be very important because, as will be discussed below, it means that express conditions are treated differently from "implied-in-law" conditions. Implied-in-law conditions may be satisfied--and the duties on which they depend can become due--even if the conditions are only substantially fulfilled. But if it is an express condition that a party provide some performance, then that party must perform completely, or risk not receiving anything in return for that performance! This result can be very harsh. In fact, it might result in what some courts call a "forfeiture."

*** **DEFINITION:** A **forfeiture** is basically a loss of something to another person because of a breach of contract, or other failure to act as required by law, with no adequate legal remedy for the party suffering the loss.

For example, if a contractor in a service contract did a lot of work for an employer but had no legal way to receive anything in return, that would be a forfeiture. The reason is that there would be no way the contractor could get the value of his work back except to be paid for it. Courts generally do not like forfeitures, because they can be harsh and may result in unjust enrichment.

Because of this potential for harsh results, many courts prefer not to find that express conditions exist in contracts, unless it is clear that the parties intended an express condition. Of course, this depends on the language

in the contract. If that language does not very clearly create an express condition, then courts will find that there is no express condition. In addition, even if such a condition exists and is not fulfilled or excused, courts generally provide restitution to a party who has given some benefit to another party, if that is necessary to avoid unjust enrichment, under the doctrine of quasi-contract. However, it is usually better (more profitable) for a party to be paid under the contract itself than to attempt to get restitution of the reasonable value of what has been given. This will also be discussed in Sections 9.4 and 9.5, below. The potential for forfeiture where there are express conditions in construction contracts will be discussed in Section 9.5a.

One example of this "complete performance" rule is Case Study 195. In that case, the parties made a contract with the express condition that Peo finish the harvest before Rhet had any duty to pay. Because this was an express condition, Peo was required to complete the harvest, or the condition would not be fulfilled and Rhet would have no duty to pay. So even if Peo completed all of the harvest except for a small portion of one field--and the condition was not excused--Rhet would have no duty to pay! But if the condition of Peo finishing the harvest was only an implied-in-law condition, then the condition would be fulfilled if Peo substantially finished harvesting the peppers--even if Peo did not finish completely. Of course, if Peo failed to finish completely in either situation, it would be a breach of Peo's promise to harvest the peppers. So Rhet would be entitled to a remedy for the harm the breach caused to him, as will be discussed in Section 9.4c, below. But the important thing about implied-in-law conditions is that--unlike with express conditions--Rhet would have a duty to pay Peo for the work he had performed under the contract. Of course, as noted above, even where a condition is not fulfilled or excused, a party like Peo might be able to get restitution of what he has provided to the other party under the contract.

******* ***WHY IS THIS IMPORTANT?*** Why should parties consider putting express conditions in their contracts?

There are several reasons parties should consider putting express conditions in their contracts. One reason is that, as discussed in Section 9.3a, all conditions can give more power to the party whose duty to perform depends on the condition. That was the situation in Case Study 195, where the condition in the pepper harvesting contract gave Rhet more power to encourage Peo to complete the harvest, and more protection from Peo's failure to do so.

And of course, this power is especially great with express conditions, since they must be completely fulfilled for the duty that depends on them to become due. In fact, the power is so great that courts will not interpret contract language to create express conditions unless it is clearly what the parties wanted, because of the danger it will result in injustice, as discussed above. And even where it is clear that the parties created

an express condition, the potential for forfeiture remains. So express conditions are a very powerful tool.

Another reason parties should consider using express conditions is that, in some situations, such conditions can actually help the party whose performance is a condition. For example, in the real estate examples in Section 9.3a, the condition of the buyer getting an adequate loan actually helped the buyer. The reason is that if that condition did not occur, then the buyer's own duty to pay for the land would never become due. So in that case the buyer would not have to perform the rest of the contract, which might be difficult or impossible without the loan. And of course, the seller's duty to provide the land would never arise either, since that duty would probably be conditioned on the buyer providing or tendering the money.

(2) Implied-in-Fact Conditions Are Those That Courts Find Exist Because of the Apparent Intentions of the Parties to the Specific Contract, Even Though the Conditions Are Not Expressly Stated in the Contract

Sometimes courts find that conditions exist in contracts because of the apparent intentions of the parties to the specific contract, even though the conditions are not expressly stated in the contract. In particular, courts may find that such "implied-in-fact" conditions are part of contracts where one party must do something in order for the other party to be able to perform under the contract. Courts say that this shows the parties intended the condition to be part of their contract, even though they did not actually express the condition in the contract.

For example, suppose Ban and Son agree that Ban will paint Son's house with a color of paint that matches a small sample of painted wood which Son will provide to Ban. In that situation, courts would probably find that Son's provision of the sample to Ban is an implied-in-fact condition to Ban's duty to paint the house. The reason is that the parties cannot have intended that Ban be expected to paint the house with the color Son chooses if Son does not tell Ban what that color is! So in this case, if Son fails to provide the paint sample to Ban, Ban's duty to paint the house will not become due. The following Case Study contains another example of an implied-in-fact condition.

*** ***CASE STUDY 197***

FACTS An experienced bank executive named Sopheap became the new president of a large commercial bank with headquarters in Phnom Penh. Because counterfeit money had recently been a problem in the city, Sopheap decided that it would be a good idea to find out whether the currency in the bank's vaults was genuine. So she hired a reliable company called Real Currency Services to perform an inspection of the money in the vaults, for a certain fee.

However, on the day when the Real Currency inspectors came to the bank to inspect the money, the guards at the front door merely laughed and told the inspectors to go away or they would be shot. The inspectors went away.

Later that day, Sopheap's assistant telephoned Real Currency to get the results of the inspection. The Real Currency inspectors told the assistant that they had not been permitted to examine the money that day, and asked if they could arrange to have the president or her assistant help them gain access on another day. But the assistant became angry. He said that it was Real Currency's responsibility to examine the money, not the bank's responsibility. The inspectors said they had no duty to do anything until the bank allowed them access to the vaults.

QUESTION OF LAW Does this contract require the bank to allow the Real Currency inspectors access to its vaults before Real Currency's duty to inspect the money becomes due?

DECISION Yes. The bank must allow Real Currency access to the vaults if it wishes the inspection to occur, because allowing this access is actually an implied-in-fact condition to Real Currency's duty to inspect the money.

Courts say that implied-in-fact conditions exist because of the apparent intentions of the parties to the specific contract, especially where one party must do something in order for the other party to be able to perform. In this case, Sopheap and Real Currency agreed that Real Currency would inspect the money in the bank's vaults for a certain fee. There were no express conditions in the contract. However, it would be impossible for Real Currency to perform its duties under the contract--to inspect the money--unless the bank allowed its inspectors access to the vaults. Therefore, this access is an implied-in-fact condition to Real Currency's duty to inspect the money. If the bank does not provide the access, then Real Currency's duty to inspect the money will not become due.

As with express conditions, courts generally require that implied-in-fact conditions be completely and exactly fulfilled in order for the duties which depend on them to become due. So if such conditions are not completely fulfilled (or excused), such duties are not due. Many courts say that implied-in-fact conditions should be treated the same way as express conditions, because both types are based on the intentions of the parties to the specific contract in the case.

However, in practice, courts have some discretion to state implied-in-fact conditions in a way that can reduce some of the harshness and the risks of forfeiture described above. In other words, courts do have some flexibility to find that implied-in-fact conditions exist in a way that reflects the real intentions of the parties, in the circumstances of a particular case.

For instance, in the house painting example above, suppose that Son does not provide Ban with a "small sample of painted wood" to show which color he wants. However, Son does provide Ban with a colored shirt, and says he wants the house painted that color. In this situation, it appears that a court might say that the implied-in-fact condition was really that Son indicate to Ban in some reasonable way what color of paint to use. Although Son chose to do that in a way that was a little different from what the contract said, it appears that courts would find that the implied-in-fact condition had been fulfilled--Son did show Ban what color to use--and that Ban's duty to paint the house had become due. Of course, technically, Son did not follow a promise in the contract, and this might be a breach. But it might be difficult for Son to show any real damage from such a breach, and it seems unlikely that it would have any real effect on the performance of the contract.

(3) Implied-in-Law Conditions Are Those That Courts Find Exist in Contracts in Order to Achieve Justice in Certain Types of Situations

Implied-in-law conditions are those that courts find exist in contracts in order to achieve justice in certain types of situations. In these situations, the law imposes certain conditions on contracts without regard to what the parties may have actually intended when they made their contract (unless the parties expressly put a different condition in their contract).

Implied-in-law conditions are also called constructive conditions, because in these situations the court actually "builds" the conditions into the contract! This is similar to the situation with quasi-contracts, which are sometimes called "constructive contracts" because the courts may impose them in certain situations, even if the parties never actually had any agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 contains further discussion of quasi-contracts.

There are several types of situations where courts find that implied-in-law conditions exist, unless the contract itself says something different. Three of the most important of these situations are where:

(1) the performances of the parties can occur roughly simultaneously, in which case each performance is a condition concurrent to the other party's duty to perform (as explained above in Section 9.3b);

(2) one party's duty requires a period of time to perform and the other party's duty does not, in which case the performance that takes more time is generally a condition precedent to the other party's duty;

and (3) one party's performance is to occur earlier in time than the other party's performance, in which case the earlier performance is generally a condition precedent to the duty to provide the later performance.

Each of these types of situations is briefly explained below.

(1) Where the performances of the parties can occur roughly simultaneously, each performance is generally a condition concurrent to the other party's duty to perform. This idea was already explained briefly in Section 9.3b above, which discussed conditions concurrent. Where the performances of the parties can occur roughly simultaneously and the contract does not provide otherwise, courts imply that the performance of each party is a condition concurrent to the duty of performance of the other party. Each party must perform in order for the other party's duty to become due. And as explained above, courts imply such concurrent conditions even though the contract itself says nothing about which party must perform first!

There are many examples of situations where courts might find implied-in-law conditions concurrent. These conditions often exist in land sale and sale of goods contracts, because those can typically be performed roughly simultaneously. One example is the one in Section 9.3b about the contract for the sale of a textbook by Kanal to Bun for 10,000 riels. That was a situation where a court would find an implied-in-law condition that the parties' duties to perform were each conditioned on the other party's performance. And Case Study 196 is another example. In that case, where Samath agreed to buy Chhon's car for $5,000, the court found that there was an implied-in-law condition that each party's duty to perform was conditioned on the performance of the other party. So Chhon had no right to demand that Samath pay the money before Chhon provided (or tendered) the car.

The reason courts imply concurrent conditions in these situations is to do justice. The law says that, unless the parties agree otherwise, it would generally not be fair to require one party in these situations to perform a substantial amount of time before the other party performs, or at least tenders performance. Since the parties can perform basically at the same time, the law wants to encourage them to do so. So it says that each party must at least tender performance before the other party's duty to perform is due. This rule gives the parties some protection from the risk that they will perform first but never receive a performance in return.

(2) Where one party's duty requires a period of time to perform and the other party's does not, the performance that takes more time is generally a condition precedent to the other duty. In many contracts, the performance of one party takes a certain amount of time, but the performance of the other party can occur almost instantaneously. For instance, in the house painting example in Section 9.3c above, the painting of the house would take a substantial period of time for Ban to perform. But the payment by Son

could be accomplished in only a few seconds. So courts would probably imply that Ban's painting of the house would be a condition precedent to Son's duty to pay. In other words, Son would have no duty to pay for the painting until Ban actually finished painting the house.

Another example might be where a passenger hires a moto driver to take him to a certain destination. In that situation, the moto driver's performance (driving to a destination) would probably take a certain amount of time, but the passenger's performance (paying the fare) would not take much time. So unless the contract said something different, a court would probably imply that the moto driver's duty to perform would be a condition that would have to be fulfilled (or excused) before the passenger's duty to pay became due.

The following Case Study contains another example of the way courts imply conditions in this situation.

*** ***CASE STUDY 198***

FACTS The Ministry of Roads signed a contract with the Tough Construction Company in which Tough agreed to make some repairs to one of the most important highways in the nation. The parties agreed that the Ministry would pay $100,000 for the work, and they anticipated that the work would take about two months to complete. The contract said nothing about when payment would occur.

A few weeks after the work began, the Tough Company became concerned about security on the road. The Company asked the Ministry to pay for all of the work within the next week. But the Ministry refused, saying the contract did not require that. The Company threatened to stop work unless the Ministry paid the money right away.

QUESTION OF LAW Does the Tough Company have the right to be paid for the road work before it performs the repairs?

DECISION No. The Tough Company does not have the right to be paid before it performs the repairs, because its performance of the repairs is an implied-in-law condition precedent to the Ministry's duty to pay for the work.

In many jurisdictions, courts say that implied-in-law conditions exist where the performance of one party's duties requires a substantial amount of time to complete, but the performance of the other party's duties does not, even where there is no express condition in the contract. Specifically, courts say that the performance of the duty that takes more time is a condition precedent which must occur (or be excused) for the duty of the other party to become due.

In this case, the Ministry and the Tough Company agreed that the Tough Company would perform about 2 months of road repairs for $100,000. Obviously the repairs will take a substantial amount of time, but the payment

of the money can be performed almost instantaneously. In this type of situation, the performance that will take some time (the Tough Company's road repairs) is a condition precedent which must occur in order for the duty of the other party (the Ministry's duty to pay) to become due. So in this case, a court would probably say that the Ministry's duty to pay will not be due until the Tough Company actually performs the repairs. The Ministry is not required to pay the money until the Tough Company performs the repairs.

*** ***WHY IS THIS IMPORTANT?*** Why do courts imply conditions in situations where one party's performance takes some time and the other party's performance does not?

Courts imply conditions in this situation in order to do justice by offering some protection to the party who can perform almost instantaneously. In many cases, if the party who could perform quickly was required to do so before the other party performed, the other party might be less likely to complete performance. For example, in Case Study 198 above, if the Ministry was required to pay Tough Construction before Tough performed the work, it might be less likely that the Company would actually finish on time--or finish at all.

In addition, it appears that there are many situations where the party who can perform quickly (often by paying money) is more established in a particular place than the other party. This means that if anything goes wrong in the performance of the contract, it may be easier for the other party to find that more established party and seek compensation than for the established party to find the first party. For example, if one party hires another to do some work on the first party's car, building, real estate, or other object in return for money, the party performing the work generally knows where to find the paying party, or at least has some control over the other party's property (as with repairs on a car). But the party doing the work may be harder to locate, especially if that party does not reside nearby, since the work that party is doing does not relate to his own property. In fact, in some cases, if such parties were paid before they did their work, they might be tempted to simply go away before completing their performance! This may also be true of many employment contracts, where the employee (whose duties take some time to perform) may be harder to locate than an established employer (who can usually perform quickly by simply paying money). It might be true of some transportation contracts, such as moto driving contracts, where the moto driver (whose duties take some time to perform) may be harder to locate than the passenger (who can usually perform quickly by simply paying money). And the moto driver might find it much easier to simply go away without performing than the passenger on foot would!

In any case, in these situations, the law appears to want to discourage parties who can receive so quickly all the benefits of a contract from failing to perform their own duties fully. And the law wants to give the other parties to such contracts some protection against this. So performances that take

some time to complete are generally conditions precedent to duties that can be performed almost instantaneously. Of course, it might also be argued that this rule tends to help more established or wealthier parties--such as employers and property owners--by requiring that they receive full performance of various services before they are required to pay for them.

(3) Where the performance of one party's duty is to occur earlier than the performance of the other party's duty under the contract, the performance of the earlier duty is generally a condition precedent to the later duty. Sometimes contracts do not contain express conditions, but do provide that the performance of one party is to occur at an earlier time than the performance of the other party. For example, a contract may state that one party is to perform one week after the contract date, and the other party is to perform two weeks after the contract date. In this type of situation, the law says that the performance which is to occur earlier is generally a condition precedent to the duty to provide a performance that is to occur later.

One example of this rule might be if the terms of a contract between a ferry company and a passenger were that the passenger would pay for a trip across a river, and that after that, the ferry would take him across the river. In that situation, courts would probably imply that the passenger's payment of the fare was a condition precedent to the ferry company's duty to take him across the river. This is because the terms of the contract say that the passenger's performance is to occur first. This is true even though the performance of the ferry company (taking the passenger across the river) will obviously take longer than the performance of the passenger (simply paying the money)! The reason is that the contract in this example actually says something that helps the court decide which performance should occur first. The things parties actually say in their contracts are often stronger than general legal rules, such as the general rule that performances that take some time are usually conditions precedent to duties of performances that do not take much time.

*** ***WHY IS THIS IMPORTANT?*** Why do courts imply conditions in situations where the performance of one party is due before the performance of the other party under the contract?

The reason courts imply conditions in this situation is to offer some protection to the party whose performance is due later under the contract itself. It appears that the law assumes that, unless the parties agree otherwise, it is generally fair to require the party whose performance is to occur first under the contract to actually perform before the other party's duty is due.

For instance, this may be the case with some transportation contracts, such as the ferry example above. In that case, even though it is the passenger who can perform quickly and the ferry company whose performance will take some time, it may actually be the ferry company that needs more protection!

This is because it may be the ferry company that is more established and easier to locate in the event of a performance problem. And it may actually be the passenger who would find it easier not to perform--and go away quickly--if he was able to cross the river without paying until he reached the other side! These might be reasons why the ferry company might insist in the contract itself that the passenger perform first. So the law may want to protect the party whose performance takes longer in that type of situation.

However, courts do not imply this type of condition where the contract says nothing about when the parties' performances are to occur, as may be the case in many other transportation contracts. For example, as discussed above, in moto contracts, it may be the passenger who needs more protection, and the law will probably assume that the moto driver must perform first unless the contract says otherwise. And even with a ferry contract, if the contract itself said nothing about the time of performance, the law would probably assume that the ferry operator's performance would be a condition precedent to the passenger's duty to pay.

One of the most important aspects of implied-in-law conditions is that they can be fulfilled by complete performance, or by substantial performance. This means that, unlike the situation with express and implied-in-fact contracts, full and complete performance is not required for implied-in-law conditions to be fulfilled. So as long as an implied-in-law condition is substantially performed, the duty which depends on that condition becomes due.

Substantial performance can occur even if there is a breach of the promise of that performance, as long as it is only a minor breach. In fact, substantial performance actually means that there has not been any material (important) breach. On the other hand, if there is a material (important) breach of such a promise, then the condition has not been substantially fulfilled. Of course, where there is a minor breach, the party who is injured by the breach is entitled to a remedy for the damage caused to him by the other party's failure to perform fully. But the non-breaching party's duty to perform is due despite the minor breach by the other party. Whether there is substantial performance (and only a minor breach), or whether there is not substantial performance (and a material breach), will depend on the circumstances of each individual case. These will be discussed in much more detail in Section 9.4c below. For now, it is important simply to understand that implied-in-law conditions may be fulfilled by complete performance, or by substantial performance, and that in the substantial performance situation, the duty of the other party will become due even though there has not been complete performance! Obviously, whether a condition is implied-in-law or not can have a big impact on the performance of a contract.

For instance, in Case Study 198, suppose the road repair contract said nothing about the time of performance, and that the Tough Company substantially finished the work, but did not completely finish it. The Company

may have finished all the work except for some minor repairs to the road surface in a few places. If a court decided that the Company had substantially finished the work--because the breach of its promise to perform was only minor--the court would say that the implied-in-law condition in the contract had been fulfilled. That would mean that the duty of the Ministry to pay for the work would become due--despite the fact that the work was not completely finished! Of course, the Ministry would be entitled to a remedy for the amount of damage caused by the Tough Company's failure to perform completely, and so the Ministry might not have to pay the full amount due under the terms of the contract. By comparison, if complete performance was required for the Ministry's duty to pay to become due, then the Ministry would have no duty to pay under the contract unless the Tough Company completely finished the road repairs--including the minor repairs to the road surface.

The basic reason for this "substantial performance" rule appears to be that the law feels that the party whose performance depends on the condition will receive the substantial benefit of his bargain. It seems that when courts impose conditions on contracts that the specific parties may never have intended--implied-in-law conditions--the courts are reluctant to require also that the conditions be completely performed before the duty that depends on them becomes due! It may be that courts feel this could often be unfair to the party who is required to complete such a performance, in cases where that party may have never expected to be required to perform so exactly in order to receive any performance in return. By contrast, courts seem to feel that express and implied-in-fact conditions should generally require complete performance, since those are more closely connected to the actual intentions of the particular parties to the contract.

Of course, a particular contract may contain many different duties. And courts must examine each contract carefully to see which duties relate to which other duties. The explanations above are general guidelines about what may happen when it is fairly clear that a particular performance by one party is being exchanged for a particular performance by another party. If a contract required many different performances between the parties, the court would have to examine all the relevant circumstances to determine the relationships between all the duties.

(4) Summary of Some Basic Differences among Express, Implied-In-Fact, and Implied-In-Law Conditions

The chart below illustrates some of the basic differences among express, implied-in-fact, and implied-in-law conditions.



Illustration: Comparison: Express, Implied-in-Fact, and Implied-in-Law Conditions

	EXPRESS	IMPLIED-IN-FACT	IMPLIED-IN-LAW
1. How is it created?	Expressly in the contract.	Implied based on the apparent intentions of the parties to the specific contract.	Implied by courts to achieve justice in certain types of situations.
2. What is its legal effect?	Must be fulfilled or excused for a certain contract duty to become due.	Must be fulfilled or excused for a certain contract duty to become due.	Must be fulfilled or excused for a certain contract duty to become due.
3. What is required for it to be fulfilled?	Requires complete performance.	Requires complete performance (though courts have some discretion to state in fair way to achieve justice).	Requires at least substantial performance (will also be fulfilled if there is complete performance).

9.4 A Contract Duty Does Not Become Due Until Any Conditions on Which the Duty Depends Are Fulfilled or Excused

As noted in Section 9.3, when contract duties depend on conditions, those duties do not become due for performance until any conditions on which they depend are fulfilled or excused. This basically means that the conditions must actually occur, or be excused for some reason the law says makes it unfair to expect them to occur. If such conditions are fulfilled or excused, then the duties that depend on them become due (except for conditions subsequent, which terminate duties). If such conditions are not fulfilled or excused, then the duties that depend on them do not become due, and the party who has those duties is not legally required to perform them.

Conditions are generally fulfilled if they actually occur as stated in the contract, or by the law (in the case of implied conditions). This is true whether the conditions are actually some performance by a party, or an independent event, such as whether it rains on a particular day. Where the condition is an independent event, it is fulfilled when it occurs, as explained in Section 9.4a below. Where the condition is the performance of a party, it is fulfilled by complete performance, as discussed in Section 9.4b below. Where the condition is implied-in-law, it may also be fulfilled by substantial performance, as explained in Section 9.4c below.

Conditions are excused in certain situations where the law basically says it would be unfair to expect them to be fulfilled. For example, a condition on which one party's duty depends will generally be excused where that party improperly rejects a tender of performance, such as a tender of goods in a sale of goods contract. If that occurs, then courts say the condition is excused,

which means the tendering party need not actually fulfill the condition in order to make the other party's duty become due. Instead, because of the improper rejection, the rejecting party's duty becomes due even though the condition is not fulfilled! Some of the important ways in which conditions may be excused are discussed in Sections 9.4 below. In particular, conditions may be excused by:

(1) an anticipatory repudiation (Section 9.4d);

(2) prospective inability or unwillingness to perform (Section 9.4e);

(3) the failure or occurrence of a prior condition (Section 9.4f);

(4) improper rejection of a tender of performance (Section 9.4g);

(5) wrongful prevention or hindrance (Section 9.4h);

(6) waiver or estoppel (Section 9.4i); or

(7) impossibility of performance (Section 9.4j).

It appears that the rules about excuse of conditions are applied most frequently to conditions precedent and conditions concurrent. Where there are conditions subsequent, the duty to perform is already due, and there seem to be fewer situations where some circumstance will excuse a condition that will terminate that duty.

There are also a few limits on the rules about fulfillment and excuse of duties in particular situations. Where a contract is severable, the failure of a condition may not affect the whole contract, as discussed in Section 9.4k. And the law imposes certain limits on conditions that are actually the approval of a party to the contract or a third party, as discussed in Section 9.4l.

Before discussing the particular ways conditions may be fulfilled or excused, it is important to explain one general aspect of the rules about conditions. As noted above, even where a condition is not fulfilled or excused (or where a condition subsequent has terminated a duty), a party who has provided some benefit to the other party can generally get restitution of what he has provided, to the extent needed to avoid unjust enrichment. Of course, this amount may be less than the amount the party might have been paid under the contract. And the amount will be reduced by any damage caused to the other party, if the party seeking restitution breached the contract. The effects of breaches of contracts will be further discussed in Section 9.6b, below.

9.4a Occurrence Fulfills a Condition

The basic, general rule about conditions is that a condition is fulfilled if it occurs as stated in a contract, or as stated by the law (in the case of implied conditions). If a condition is fulfilled, then the duty that depends on that condition becomes due, and the party with that duty must perform it (except for conditions subsequent). This general rule applies where the condition is a performance promised by one of the parties, such as completing electrical work

in a construction contract. It also applies where the condition is some event unrelated to the parties' performance, such as whether the price of gold is above a certain level on a certain date. The different types of conditions were discussed in Section 9.3 above. The Case Study below is an example of how the occurrence of a condition which is not a performance of the parties can cause the duty of a party to perform to become due.

*** ***CASE STUDY 199***

FACTS The Ministry of Education bought fire insurance for 100 of its primary schools from the Reliable Insurance Company. The insurance policy stated, among other things, that if any of the insured schools was damaged by fire during the policy period and the Ministry gave adequate notice of this to Reliable, then Reliable would pay within a reasonable time for all property damage to that school, up to a $100,000 limit per school. The policy period was three years.

Two years after the policy went into effect, one of the schools covered by the policy was badly damaged in a fire. The Ministry learned that the damage would cost $80,000 to repair. The Ministry notified Reliable immediately, and asked for the money to repair the school. Reliable investigated the policy claim and found that it was covered by the policy. However, Reliable said the Ministry had to wait until the end of the policy period to get its money, because the money was not available right then. The Ministry asked the court for help.

QUESTION OF LAW Does the insurance contract require Reliable to pay for the damage to the Ministry's school within a reasonable time?

DECISION Yes. Reliable is required to pay for the damage within a reasonable time because the damage to the school by fire and the Ministry's adequate notice of that event fulfilled the conditions precedent to the insurance company's duty to pay for the damage.

Conditions are fulfilled when they occur, whether the conditions involve performances of the parties or other events. When conditions occur, the duties that depend on them become due for performance (or are terminated, for conditions subsequent).

In this case, a fire insurance policy stated that, if one of the Ministry's insured schools was damaged by fire and the Ministry gave adequate notice of that damage to Reliable, then Reliable was required to pay within a reasonable time for the damage to that school, up to $100,000 per school. One of the schools actually was damaged in this way, the Ministry gave adequate notice, and Reliable admitted that the claim was covered by the policy. In this situation, the damage to the school by fire and the proper notice were express conditions precedent which both had to occur in order for Reliable's duty to pay for the damage to become due. And that is what happened: both conditions

occurred. One was an independent event (the fire), and one was a performance of the Ministry (giving the notice). Therefore, Reliable has a duty to pay for the damage to the school within a reasonable time. The end of the policy period is probably not a reasonable time.

9.4b Where a Condition Is Also a Performance Promised in the Contract, Complete Performance Fulfills the Condition

In many cases, a condition is also a performance promised by one of the parties under the contract. In that situation, the ideal way for the condition to be fulfilled is for the party who has promised that performance simply to provide complete performance. Complete performance means the party performing does exactly what the contract requires. If that party does perform completely, then the duty which depends on the condition becomes due for performance (or is terminated, in the case of conditions subsequent). This is true whether the condition is express, implied-in-fact, or implied-in-law. And it is true whether the condition is a condition precedent, a condition concurrent, or a condition subsequent. Complete performance always fulfills a condition.

For example, in Case Study 195, Peo's harvesting of the red peppers was an express condition precedent to Rhet's duty to pay for the harvesting. In that case, if Peo had completely performed the harvest, Rhet's duty to pay Peo 100,000 riels for the harvest would have become due.

The Case Study below contains another example.

*** ***CASE STUDY 200***

FACTS The Rubber Development Company agrees to sell 1,000 tons of rubber to the Everlasting Tire Company for use in manufacturing heavy duty truck tires. The Rubber Company delivers all of the rubber as required by the contract, and the Tire Company accepts the rubber.

After a few weeks, the Rubber Company has not received payment for the rubber. So the Rubber Company sends several written requests for payment to the Tire Company, saying that the Tire Company's duty to pay for the rubber is due. The Rubber Company also places a number of telephone calls to the Tire Company. However, the Tire Company does not respond to the Rubber Company's communications. So the Rubber Company asks the court for help.

QUESTION OF LAW Does the contract require the Tire Company to pay for the rubber that the Rubber Company has delivered?

DECISION Yes. The Tire Company's duty to pay for the rubber has become due because the Rubber Company's delivery of the rubber

was a condition concurrent to the Tire Company's duty to pay, and that condition has been fulfilled by the Rubber Company's complete performance.

When a condition is also a performance promised by one of the parties to the contract, the condition can be fulfilled by complete performance, no matter what kind of condition it is. When such a condition is fulfilled by complete performance, the duty that depends on it becomes due for performance (or is terminated, in the case of conditions subsequent).

In this case, the Rubber Company promised to provide 1,000 tons of rubber to the Tire Company, and the Rubber Company completely performed its promise. When the Rubber Company completely performed, it actually fulfilled an implied-in-law condition concurrent to the Tire Company's duty to pay. This is because the duties of the parties in this sale of goods contract could be performed roughly simultaneously. And because of the Rubber Company's complete performance, the Tire Company's duty to pay for the rubber is due. In this situation, the court will order a remedy to help the Rubber Company.

In addition to fulfilling any condition, complete performance also discharges the duty of the performing party to provide that performance. This effect will be further discussed in Section 9.6a, below.

9.4c Substantial Performance Fulfills an Implied-in-Law Condition

As explained above in Section 9.3, implied-in-law conditions can be fulfilled by complete performance or by substantial performance. In other words, complete performance is not required for implied-in-law conditions to be fulfilled! So substantial performance will fulfill that kind of condition, and will cause the duty that depends on such a condition to become due for performance. This means that substantial performance can occur even though there is a minor breach of the contract, since a party who performs only substantially has obviously failed to perform completely according to the contract.

However, this substantial performance rule applies only to implied-in-law conditions. This is because courts say that express conditions and implied-in-fact conditions must be completely fulfilled (or excused), or else the duties on which those conditions depend do not become due.

Exactly how much performance is required for performance to be "substantial" can be difficult to determine. It will depend on the particular circumstances of each case, as discussed below.

One example of substantial performance which was already explained in Section 9.3c uses the facts in Case Study 198. In Case Study 198, suppose the Tough Company substantially performed the road repair contract because

all that remained to be performed were a few minor repairs to the road surface. In that situation, the implied-in-law condition on which the Ministry's duty to pay depended would be fulfilled, and the Ministry's duty to pay would become due. Of course, as noted above, the Ministry would be entitled to a remedy for the damage caused by the Tough Company's failure to perform completely. So the Ministry might not have to pay the full amount due under the terms of the contract.

(1) Substantial Performance and Breach of Contract

One of the most important parts of the rule about substantial performance is the relationship between substantial performance and breach of contract.

*** **DEFINITION:** A **breach of contract** is a failure to perform a contract promise without any legal excuse.

A breach is basically a failure to perform according to a promise (express or implied) that a party has made in a contract, when the duty to perform that promise has become due. Of course, a contract duty might not become due at all because of a failure of a condition to occur (as explained in Section 9.3). In addition, such a duty might not be due because it has been discharged by a breach or some other event related directly to performance of the contract (as explained in Section 9.6); by a later agreement or statement of the parties (as explained in Section 9.7); or by operation of law (as explained in Section 9.8). Circumstances like those might be considered legal excuses for a failure to perform a contract promise.

In any event, assuming the duty to perform a promise is due, the way to find if a breach has occurred is simply to ask whether the party with that duty has failed to perform it when that party was required to do so. For example, if a party makes a contract in which he promises to repair a road for a Ministry, but the party fails to repair that road according to the contract, then the party has breached the contract. The reason is that the party has failed to perform according to the promise he made in the contract.

A breach can also occur where a party fails to perform according to an implied promise. This might occur where a party prevents another party from performing or receiving the benefits of the contract. Some courts might consider such behavior to violate an implied promise not to interfere with the other party's performance or enjoyment of the benefits of contract. It would also violate the implied duty of good faith and fair dealing, as discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and as will be explained in Section 9.5c, below. For instance, in the road repair example, such a breach might occur if the Ministry did not allow the road repairer access to the road to make repairs. Of course, allowing such access would probably also be an implied-in-fact condition to the duty to perform the repairs.

Any failure to perform according to the promises in a contract, without a legal excuse, is a breach. That is, in determining whether there is a breach or not, it does not matter whether the failure to follow the promise was a complete failure, a moderate failure, or only a small failure! It does not matter whether a party performed half the contract correctly but did no more, or whether the party tried to perform the whole contract but did so in an incorrect way. And it does not matter whether the party who failed to perform intended to breach the contract or not. Any failure to perform according to the contract, without a legal excuse, is a breach.

However, the legal effects of the breach will vary according to how serious the breach is. Specifically, the legal effects depend on whether the breach is material (important) or minor. Determining whether a breach is material or minor can be difficult. This will be explained in detail below. In addition, the more serious a breach is, the more serious the remedy a court orders is likely to be.

It is very important to remember that a breach is different from the failure of a condition to occur. A breach is basically a failure to perform according to a promise in the contract. But a failure of a condition to occur simply means that an event specified by the contract or the law has not occurred. That event might be the performance of a legal duty under the contract, or it might be some other event. So a condition can be fulfilled even though a breach occurs, as in the case of substantial performance. And a condition can fail even though there is no breach!

Another important difference between a breach and a failure of a condition to occur is the legal result. Where a breach occurs, it gives the non-breaching party the right to seek a remedy (such as money damages) from a court for the harm the breach has caused. But where there is a failure of a condition to occur, it simply means the legal duty which depends on the condition does not become due for performance. So the failure of a condition to occur does not--by itself--give a party the right to ask a court for a remedy. It simply gives a party the right not to perform the duty which depended on the condition. On the other hand, as noted above, a condition may be fulfilled by a performance that is also a breach! That is what occurs when there is substantial performance that fulfills an implied-in-law condition: the condition is fulfilled, but the failure to perform completely is still a breach. Of course, since conditions are often some performance of the parties, the failure of a condition to occur is often also a failure to perform according to a promise in the contract--a breach. So in that situation, a duty would not become due and a party would have the right to ask a court for a remedy because of the breach. But breaches do not occur because of conditions. Breaches occur because a party has failed to perform a duty he promised to perform in the contract. These differences are also discussed in Section 9.3, above.

As noted above, the difference between a minor breach and a material (important) breach is also very important in understanding

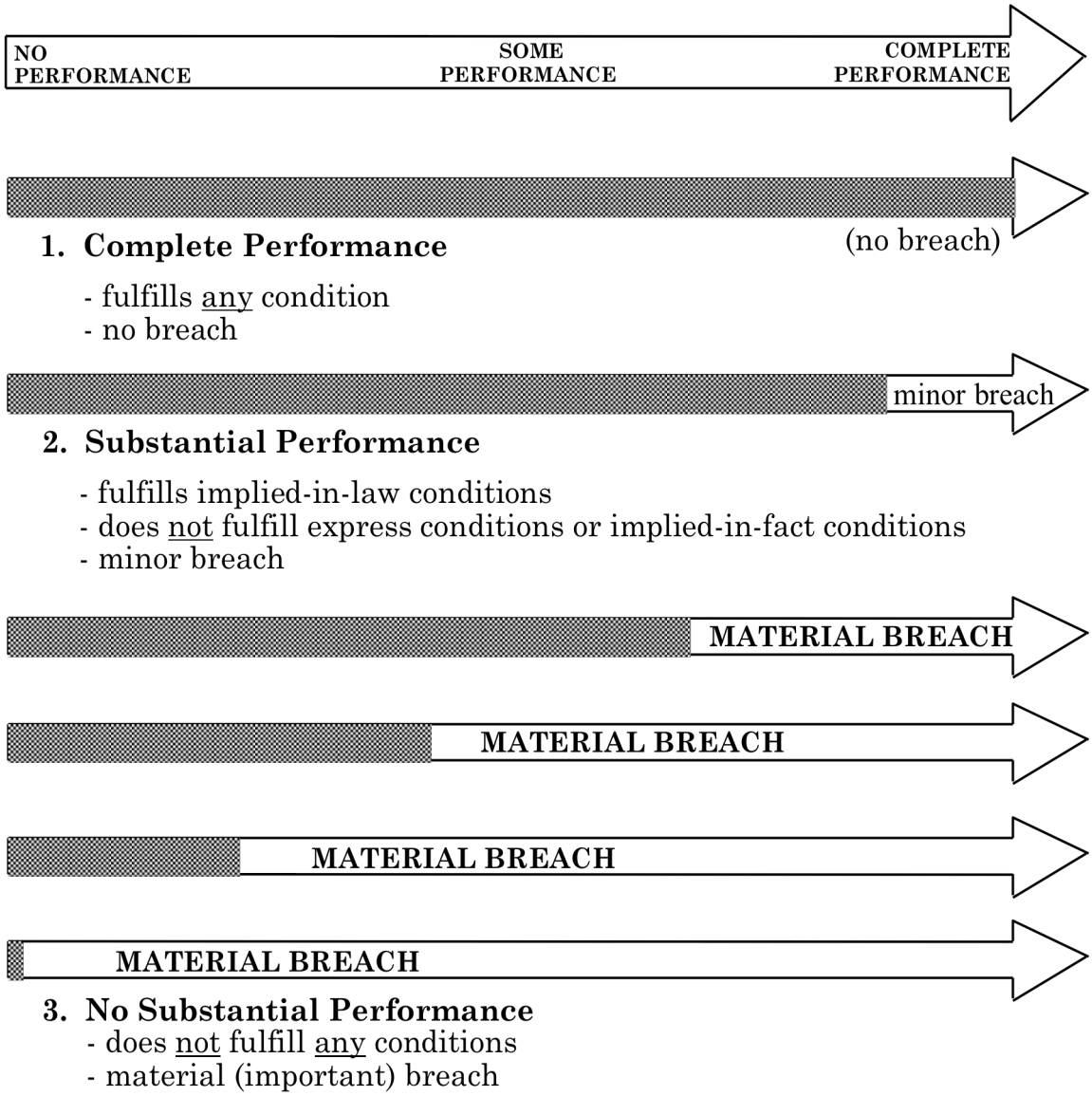
substantial performance, which will fulfill implied-in-law conditions. Substantial performance can occur even if there is a breach of the promise of that performance as long as it is only a minor breach. In fact, one way to explain substantial performance is to say that there has been no material (important) breach of the contract, but only a minor breach. This minor breach does not prevent an implied-in-law condition from being fulfilled. Of course, where there is a minor breach, the party who is injured by the breach is entitled to a legal remedy for the damage caused to him because of the minor breach. But in the case of implied-in-law conditions, the non-breaching party's duty to perform is due despite the minor breach by the other party. So in that situation, the non-breaching party must perform.

On the other hand, if there is a material (important) breach, then there has not been substantial performance. Where there is a material breach--and a condition has not been fulfilled--the party injured by the breach may seek a remedy for the breach, and the duty that depended on the unfulfilled condition does not become due for performance. So the injured party may seek a remedy and the party need not perform the duty affected by the condition. In fact, that harmed party's duty to perform his own duty may actually be discharged by the material breach of the other party. This important potential effect will be discussed further in Section 9.6b, below.

The illustration below shows the basic relationship among performance, conditions and breach of contract.



Illustration: Performance, Conditions and Breach of Contract



1. Complete Performance

- fulfills any condition
- no breach

2. Substantial Performance

- fulfills implied-in-law conditions
- does not fulfill express conditions or implied-in-fact conditions
- minor breach

3. No Substantial Performance

- does not fulfill any conditions
- material (important) breach

Please Note: In this Illustration, the basic differences between minor and material breaches are shown in diagram form to promote easier understanding. This Illustration is not meant to suggest that there is any specific, measurable distance from complete performance that means a breach is "minor" or "material." That will depend on the circumstances in each case, as discussed below.

(2) How to Tell Whether There Has Been Substantial Performance

The issue of whether there has been substantial performance (and only a minor breach)--or whether there has been no substantial performance (and a material breach)--has a very big effect on what parties and courts do when

there is a contract dispute. If the performance of a contract duty is an implied-in-law condition, substantial performance will fulfill the condition and cause the duty that depends on the condition to become due.

Whether performance is substantial or not depends on the circumstances in each case. In general, potential examples of minor breaches include minor delays in completing performance where time is not crucial, or minor problems in the quality or quantity of performance, such as the minor road repair problems discussed above. Potential examples of material breaches include delivering a completely wrong kind of goods in a sale of goods contract, or failing to perform a large part of the work required in a service contract.

Courts have developed some general rules to help them determine whether substantial performance has occurred (a minor breach), or whether such performance has not occurred (a material breach). For example, courts in the United States generally examine the five factors below to see if there has been substantial performance.

Factor No. 1: The more the party harmed has received the benefit he reasonably expected from the contract, the more likely it is that substantial performance has occurred. This is perhaps the most basic factor courts examine in determining whether performance is substantial. It simply asks how much the party harmed has received compared to what he could have reasonably expected to receive from the contract.

For example, if a buyer in a sale of goods contract receives 99% of the goods specified in the contract, it seems likely that substantial performance has occurred, based on this factor. Of course, a court would examine all the relevant factors before reaching a final decision about substantial performance.

Factor No. 2: The more the party harmed can be adequately compensated by money damages, the more likely it is that substantial performance has occurred. Money damages means a court orders the breaching party to pay money to the non-breaching party, in order to compensate that party for harm caused by the breach. This factor may depend on how easily a court can measure money damages for the breach. For example, if there is a breach of a contract for the sale of a very common item such as rice, it would probably be easy for a court to measure money damages. But it might be more difficult to calculate money damages for contract breaches involving new businesses, special services, or the loss of unique items.

The importance of this factor varies in different jurisdictions. In particular, it appears that common law courts generally award money damages more frequently than civil law courts do. Civil law courts, such as those in Germany, are more likely than common law courts to award

specific performance. Ordering specific performance means actually ordering a party to obey the contract, rather than merely ordering the party to pay money to compensate another party who has been harmed. As a result, it would seem that civil law courts would be less likely to say that this second factor was important to determining how serious a breach was.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains further discussion of remedies courts may choose when parties fail to perform contracts properly, including specific performance in Section 10.7a.

Factor No. 3: The more the party failing to perform will suffer forfeiture or hardship if the breach is considered material, the more likely it is that substantial performance has occurred. The idea of this factor is to consider how much the party failing to perform will be harmed if his breach is considered material. If the breach is material, the non-breaching party generally will have the right to not perform his own duties, and to ask a court for remedies--in other words, the right to basically terminate the contract. If the party failing to perform has already performed to a significant extent, then that party will be more likely to suffer hardship if the contract is terminated.

For example, if a party to a one day service contract worked all but one half hour of the required eight hours in that day, the working party would suffer a great hardship if his breach was considered material and the employer had no contract duty to pay him. Of course, the worker could still ask a court for restitution of the reasonable value of his services.

Factor No. 4: The more likely it is that the party failing to perform will fix or "cure" his failure and perform fully, the more likely it is that substantial performance has occurred. This factor focuses on how likely a breaching party is to perform his duty fully in the future. Many jurisdictions say that the non-breaching party must allow the breaching party a reasonable opportunity to fix or "cure" his breach, if that is still possible in the circumstances. One part of this factor which courts may consider is whether the party failing to perform has stated that he will perform fully, and how credible any such statement is. For example, perhaps the parties have dealt with each other many times before. If the breaching party has always performed with no problems in the past, or has always fixed any problems adequately in the past, it might be more likely that that party will perform fully. But if the party has been unreliable in the past, then that party may be less likely to complete or "cure" performance. And in some cases, it may be impossible to fix a defective performance, such as where it is too late for further performance to be of any use. This factor may be less important in some cases, such as situations where it would be relatively easy for the non-breaching party to find someone else to finish performance. The possibility that a breaching party may cure his breach is discussed more fully in Section 9.6b, below.

Factor No. 5: The more the party failing to perform has followed standards of good faith and fair dealing, the more likely that

substantial performance has occurred. The standards of good faith and fair dealing have already been discussed in detail in other parts of this text, such as Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and these standards will be discussed again in Section 9.5c below. These standards basically mean that a party to a contract should act honestly and not seek unfair advantage over another party (good faith), and should follow reasonable standards of fair conduct in the contract (fair dealing).

This fifth factor can be very important in helping courts decide whether breaches are material. In fact, it appears that many courts actually refuse to find substantial performance has occurred where a party's failure to perform is "willful" or in bad faith, regardless of the other four factors above! It appears that these courts reach this result based on the "good faith" part of the standard above, and not on the objective standards of fair dealing. That is, these courts basically say that a party who fails to perform in good faith has not substantially performed: "no good faith = no substantial performance." For example, if the evidence showed that a party failed to perform completely simply because he wanted to see how the other party would react--perhaps to see if he could take advantage of that party in future dealings--that would probably be a failure to follow standards of good faith. However, it appears that some of these jurisdictions do not follow this "no good faith = no substantial performance" rule in the situation where the breach is very minor. In other words, a willful or bad faith breach may not prevent substantial performance if that breach is very minor.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.4a and Chapter 8 ("Interpretation of Contracts"), Section 8.3j contain further discussion of the duty of good faith and fair dealing.

Courts generally look at all of the five factors above in deciding whether a breach is material. So no single factor will generally determine whether a breach is material, with the possible exception of the good faith part of the fifth factor. However, some factors may be more relevant or important than others in particular cases. In addition, in many cases, some factors will suggest that a breach is material, and other factors will suggest that a breach is minor. In those situations, courts do not simply add up factors to see which party wins! Instead, courts make their decisions based on which factors seem most important in the case they are considering.

The following Case Studies show how courts might apply these factors in two different situations. Case Study 201 is about a construction contract, which is a type of contract to which courts often apply the substantial performance rule.

*** ***CASE STUDY 201***

FACTS Samnang makes a contract with the New Day Construction Company in which New Day agrees to build Samnang a new house on a

large piece of land Samnang has recently bought. New Day agrees to follow a set of plans that Samnang provides, and Samnang agrees to pay a total of $10,000 for all the labor and materials. The contract contains no express conditions.

After several months, New Day stops work and notifies Samnang that it has finished the job. It asks for the $10,000 Samnang promised to pay under the parties' contract. But when Samnang goes to look at the house, he finds some problems. Specifically, New Day has failed to put railings on the balconies, and failed to attach an apsara decoration to the front of the second floor of the house, as the building plans required.

Samnang is very upset, and he refuses to pay New Day any money until New Day fixes the problems. New Day says it is sorry Samnang is not happy, but it has finished the house, and in any event all of its workers are now far away in a different province on another, much bigger construction job. Samnang still refuses to pay any money. New Day asks the court for help.

QUESTION OF LAW Has Samnang's duty to pay New Day for the construction of the house become due?

DECISION Yes. Samnang's duty to pay for the construction of the house has become due because New Day has fulfilled the implied-in-law condition precedent to Samnang's duty to pay, by substantially performing the construction work required by the contract.

Where one party's performance will require a substantial amount of time to complete but the other party's performance can occur almost instantaneously, courts generally say that the completion of the longer performance is an implied-in-law condition precedent to the duty of the other party to provide the shorter performance.

In this case, the construction contract between the parties said that New Day had a duty to build a house according to the plans Samnang supplied, and that Samnang had a duty to pay New Day $10,000 for that construction. The contract had no express conditions. In this situation, a court would probably say that New Day's duty to construct the house was an implied-in-law condition precedent to Samnang's duty to pay the $10,000, since the construction would take some time to perform but the payment could basically occur in a moment. So the important question in this case is whether the condition precedent to Samnang's duty to pay has been fulfilled.

Where contracts contain implied-in-law conditions, those conditions may be fulfilled by complete performance or substantial performance. In this case, New Day failed to complete the house according to the plans Samnang supplied, because the balcony railings and the apsara decoration were missing. So the court will find that New Day did not provide complete performance, and New Day breached the contract.

Next, the court will ask whether New Day provided substantial performance, which is possible despite New Day's breach. In order to determine whether a party provided substantial performance, many courts in the United States look at five factors: (1) how much benefit the other party received; (2) how well the other party can be compensated by money damages; (3) how much hardship or forfeiture the party failing to perform will suffer if the breach is considered material; (4) the likelihood that the party failing to perform will perform fully in the future; and (5) whether the party failing to perform has acted according to the standards of good faith and fair dealing.

In this case, it appears that Samnang has received almost all of the benefit he expected, since he has an entire new house except for some railings and an apsara decoration. It also appears that he could be adequately compensated for the breach by money damages. This is because it is probably fairly easy to calculate how much it would cost to have the work finished, and probably not hard to find someone to finish the work. In addition, it appears that New Day would suffer considerable hardship if the breach was treated as material and New Day did not receive compensation under the contract. This is because New Day performed a great deal of work--almost everything in the contract. On the other hand, it is not likely that New Day will finish the work here, since its workers are all far away on another job. But there is no evidence that New Day violated the standards of good faith, since there is no evidence that it acted dishonestly or sought unfair advantage. It is possible that New Day's failure to complete the work violated reasonable standards of fair conduct, since a reasonable builder might have made sure to finish the railings and the apsara. But it is unlikely that a court would find such a violation to be very important, since the failure was not very serious compared to the size of the rest of the construction job.

On the whole, based on the factors above, it seems likely that a court would find that New Day substantially performed this contract. The important factors in this case--including the great benefit to Samnang, the adequacy of money damages, and the great potential hardship to New Day--appear to indicate that substantial performance has occurred. So the implied-in-law condition precedent to Samnang's duty to pay was fulfilled, and Samnang's duty to pay became due. Of course, Samnang is entitled to a remedy for the damage he has suffered because of New Day's failure to perform completely.

*** ***CASE STUDY 202***

FACTS Vanna is the president of a book publishing company. One day, she decides that there would be a good market for some comprehensive law books about important subjects. So she contacts several legal scholars to ask if they would consider writing such books for her company. One of the contracts she makes is with a prominent law professor named Emma. Emma and Vanna agree that Emma will write an authoritative text on contract law. The contract says that Emma is required to finish her final draft of the book

within one year of the contract date, and that Vanna's company will pay Emma $10,000 for writing the book one month after Vanna receives the final draft.

Emma works on the book for about five months, and is about half way through her first draft, when she gets a telephone call from an executive at the Big Bear Beer Company. The executive tells Emma that she has won a big beer contest! Her prize is an all-expenses-paid, 4-month tour of the biggest nations on earth, including Russia, China, Canada and Brazil. Emma celebrates all night at the Heart of Blackness pub, and leaves within a week on her free tour. She leaves her book draft behind and never works on it again.

At the end of the year, Vanna visits Emma's house to ask about the law book. Vanna learns from a friend of Emma's that has Emma taken an attorney job representing indigenous peoples in the Brazilian rain forest, and that she is unlikely to work in Asia for several years. Vanna finds the first draft of the book Emma had agreed to write, but Vanna sees that it will require a lot of work before it might be ready for publication. Within a few weeks, Emma returns on a brief trip from Brazil and demands the contract price from Vanna, saying she has substantially performed the contract. Vanna refuses to pay. Emma asks the court for help.

QUESTION OF LAW Has Vanna's duty to pay for the contract law book become due?

DECISION Probably not. Vanna's duty to pay for the book has probably not become due because Emma has probably not substantially performed her promise to write the book.

Where a contract says that one party's performance will occur at an earlier time than the other party's performance, courts generally say that the earlier performance is an implied-in-law condition precedent to the duty of the other party to provide the later performance. In this case, Vanna and Emma agreed that Emma would write and supply the final draft of a contract law book within one year, and that Vanna's company would pay Emma $10,000 for the book within one month after receiving the final draft. The contract had no express conditions. A court would probably say that Emma's duty to write the book was an implied-in-law condition precedent to Vanna's duty to pay the $10,000, since the writing of the book was scheduled to occur earlier than the payment of the money. So the important question in this case is whether the condition precedent to Vanna's duty to pay has been fulfilled.

Where contracts contain implied-in-law conditions, those conditions may be fulfilled by complete performance or substantial performance. In this case, Emma failed to complete her work on the book. So she has not provided complete performance, and she has breached the contract.

Next, the court will ask whether Emma provided substantial performance, which is possible despite her breach. In order to determine whether a party provided substantial performance, many courts in the United States look at five factors: (1) how much benefit the non-breaching party received; (2) how well the non-breaching party can be compensated by money damages; (3) how much hardship or forfeiture the party failing to perform will suffer if the breach is considered material; (4) the likelihood that the party failing to perform will perform fully in the future; and (5) whether the party failing to perform has acted according to the standards of good faith and fair dealing.

In this case, Vanna received some benefit, since she did receive about half of a first draft of a contract law text. However, what Vanna received is not anything like what she reasonably expected to receive. She expected a complete final draft, not merely half of a first draft. In addition, it may be difficult for Vanna to be adequately compensated by money damages. This is because it may be difficult to measure how much she has been damaged by Emma's failure to perform. Vanna may be able to hire another scholar to complete the text--or the scholar may insist on starting over again. In addition, Vanna's company may have lost profits because, no matter what happens, it will not be able to start selling its contract law book as soon as it would have if Emma had completed the book on time. On the other hand, it appears that Emma will suffer some hardship or forfeiture if her breach is treated as material and she cannot recover money under the contract, since she did work on the text for about 5 months. It is not likely that she will complete her performance by finishing the text, since she has not made a new promise to do so, and since she is living far away and working at another busy job. This factor might be important in this situation, since Emma might be able to finish the book far more efficiently (and cheaply) than anyone else, because of all the special knowledge she has gained in working on the first draft. In addition, a court might well find that Emma had not acted according to the standards of good faith and fair dealing, since she basically abandoned her contract obligations in order to have fun on a free trip around the world. A court might find that this behavior was dishonest, or at least very unfair to Vanna's company. It might also violate reasonable standards of fair dealing, since a reasonable person would probably not abandon an important contract in that way.

On the whole, based on the factors above, it seems likely that a court would find that Emma did not substantially perform this contract, and that her breach was material. The important factors in this case--including the inadequacy of what Vanna received, the potential problems with money damages, and Emma's apparent lack of good faith--suggest that substantial performance has not occurred. So the implied-in-law condition precedent to Vanna's duty to pay probably was not fulfilled, and Vanna's duty to pay probably did not became due. Therefore, Vanna has no duty to pay Emma under the contract. Of course, Emma could ask the court for restitution of the reasonable value of what Vanna did receive. However, in these circumstances

Emma might have trouble showing that there was much unjust enrichment of Vanna, especially because of how much it will cost Vanna to have the book finished, the profits Vanna has lost because of Emma's breach, and Emma's apparent lack of good faith. In addition, since Emma has breached the contract, Vanna could file a breach of contract lawsuit against Emma and ask for a remedy for the damage caused to her.

One potential problem in the performance of contracts is whether substantial performance can exist even though there is some delay in the performance. In other words, if a party's performance occurs later than the contract expressly requires, courts must decide whether the performance is substantial (and there is only a minor breach), or whether substantial performance has not occurred (and there is a material breach). In general, in resolving this problem, courts will apply factors such as the five discussed above, as courts would with any other failure to perform the contract completely as required.

However, there are also some special rules to consider where the failure to perform is actually a delay in performance. First, it appears that courts generally assume that a delay in performance is not a material breach--and that substantial performance is still possible--unless that delay significantly deprives the other party of the benefit of the contract. In general, a delay may have such a serious effect where:

(1) performance by a certain time is an express condition in the contract;

(2) the contract states that "time is of the essence;"

OR (3) other circumstances indicate that the time for performance really is a crucial part of the contract.

First, the parties can actually make time an express condition in the contract. For example, the contract may say: "Saray will have no duty to pay for the goods unless they are delivered no later than November 1." In that situation, only complete performance (with no delay) will fulfill the express condition, and any delay will be a breach that causes the condition to fail. This has already been discussed.

Second, if the parties have actually stated in the contract that "time is of the essence," then courts generally say that even a short delay can create a material breach and prevent substantial performance from occurring. However, it appears that many courts say that a very short delay is a not a material breach, despite a "time is of the essence" clause, unless other circumstances indicate that such a very short delay really is very important to the agreement.

Third, even if the contract itself does not say that time is of the essence, courts might imply that time is crucial based on the particular circumstances

of the case. For example, if someone has a contract to repair a boat for a boat racing team no later than the day of the big races during the Water Festival, completion of the repair work even one day late might be a material breach and prevent substantial performance. Of course, in that situation, it seems likely that the boat repairer could recover some amount of restitution.

However, in situations other than the three described above, most courts are likely to find that some delay in performance does not prevent substantial performance from occurring, and that such a delay is only a minor breach. In particular, it appears that minor delays in performance of land sale contracts are unlikely to prevent substantial performance. In those situations, the substantial performance would fulfill an implied-in-law condition, and any duty that depended on that condition would become due for performance. Of course, even where a delay is only a minor breach, the party harmed may ask a court for a remedy for the damage caused by the minor breach. In addition, in any contract, there is some point in time at which a delay will become a material breach--a party cannot delay indefinitely and expect a court to find that he has substantially performed!

Many jurisdictions also have special rules about the rights of the buyer and the seller when there has been some failure to perform fully a sale of goods contract. In particular, these rules describe what performance by the seller will cause the buyer's duty to pay to become due. In this text, some of these rules will be discussed in detail in Section 9.5b.

*** ***WHY IS THIS IMPORTANT?*** Why do courts say that substantial performance can fulfill an implied-in-law condition and cause the duty that depends on that condition to become due?

One reason for the substantial performance rule is fairness. As noted in Section 9.3c above, it appears that courts feel the rule achieves justice because the party whose performance depends on the condition has received the substantial benefit of his bargain--and the other party has provided that benefit. It seems that when courts impose conditions that the specific parties may never have intended--implied-in-law conditions--the courts are reluctant to also require that the conditions be completely fulfilled before the duty that depends on them becomes due! Courts may feel this could result in unfairness to the party who is required to complete such a performance, where the party may have never expected to be required to perform so exactly in order to receive any performance in return. The five factors discussed above are one way a court could try to make sure that a party has actually received the substantial benefit of his bargain, and that it is therefore fair to require him to provide his performance in return.

In addition, if courts required complete and exact performance of every contract duty that was a condition to another party's duty, it could lead to great inefficiencies in the performance of contracts and the operation of the economy. It is often much more efficient, where there is only a minor breach,

to say that the party harmed does not owe the full consideration described in the contract, rather than to require the other party to perform completely or else receive nothing under the contract. This was probably the situation in Case Study 201, where it would probably have been much more efficient for Samnang to simply hire someone else to finish the minor work on his house, rather than make the busy New Day Company bring its workers all the way back from the provinces for so little work if it wished to be paid under the contract.

In fact, to require complete performance of all duties in all cases might even discourage some parties from making contracts at all. That is because the parties would be taking a big risk of forfeiture in the event that they did not quite complete the contract exactly. As everyone knows, it is difficult to complete large projects without making any errors at all. In general, the law wants to compensate fairly those who are harmed by contract breaches. But it does not wish to impede unnecessarily the operation of the market economy. So the law tries to provide fair compensation to those harmed by contract breaches, without taking punitive or extreme amounts from those who breach the contracts.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains further discussion of what courts do when parties fail to perform contracts properly.

9.4d Anticipatory Repudiation by the Party Whose Duty Depends on a Condition May Excuse the Condition

As noted above in Section 9.4, conditions are excused in certain situations where the law basically says it would be unfair or impractical to expect them to be fulfilled. If a condition is excused, it need not be fulfilled in order for the duty which depends on it to become due. In these situations, the law says that it is fair to expect the party with the duty that depends on the condition to perform that duty--even though the condition has not been fulfilled! In fact, that duty becomes due as if the condition had been fulfilled.

One of the most important reasons conditions may be excused is anticipatory repudiation by the party whose duty depends on the condition.

*** **DEFINITION:** An **anticipatory repudiation** is generally considered to be a statement by one contract party to another contract party that clearly shows that the first party does not intend to perform a contract duty in the future when that performance is due.

Basically, an anticipatory repudiation occurs where a party to an executory contract makes a statement to another party that clearly shows he will not perform a duty under the contract when that performance becomes due. Such a repudiation can occur expressly through words, or impliedly through conduct, as long as the statement clearly shows a party

will not perform. When anticipatory repudiation occurs, it excuses any conditions on which the repudiating party's duty depends, and that party's duty will become due for performance even though the conditions have not been fulfilled.

For example, suppose Sann makes a contract to sell two tons of peanuts to Chamrath, with delivery to occur in two weeks. Sann's delivery of the peanuts will be an implied-in-law condition concurrent to Chamrath's duty to pay for the peanuts. If Chamrath contacts Sann one week before delivery is to occur and says "I am sorry but I will not honor our peanut contract," then Chamrath has made an anticipatory repudiation. In that situation, Chamrath's statement excuses the condition concurrent to his duty to pay--Sann's delivery of the peanuts--and Chamrath's duty to pay will become due even though the condition has not been fulfilled.

Anticipatory repudiation also generally gives the other party the right to treat the repudiation as a material breach, and immediately ask a court for a remedy such as damages, among other options. So in the example above, Sann would have the option to treat Chamrath's repudiation as a material breach and ask the court for a remedy immediately. This will be further discussed later in this Section and in Section 9.6c, below.

An important requirement for anticipatory repudiation to exist is that the statement of repudiation must be clear. In other words, it must be clear from the words or conduct of the repudiating party that that party does not intend to perform his duty under the contract. For instance, in the peanut example above, Chamrath's statement that he would not honor his contract was clear. It left no doubt about what he intended to do. However, Chamrath's intent would not have been so clear--and there would have been no anticipatory repudiation--if he had made statements such as:

- "Business is not going well and I am not sure about our contract;"
- "This contract may be difficult for me to perform;"
- "I don't know when I will be able to pay you for the peanuts;"

or even
- "I think we should cancel this contract."

Although the statements above show doubt about whether performance of a contract duty will occur or should occur, they do not clearly show an intent not to perform. So they are not anticipatory repudiations.

The effects of an anticipatory repudiation of a contract duty vary depending on what the non-repudiating party wishes to do. Of course, as noted above, one important effect is that such a repudiation excuses any condition on which the duty depends, and causes that duty to become due for performance even though the condition has not occurred. In fact, this basically means that the non-repudiating party need not go forward with his own

performance, if that performance is a condition to the repudiating party's performance.

In addition, as noted above, such a repudiation also generally gives the non-repudiating party the right to treat the repudiation as a breach of the contract and immediately ask a court for remedies such as money damages. This is true even though the repudiating party's duty might not normally be due until the non-repudiating party has performed, because the repudiation has actually excused the condition that is the non-repudiating party's performance. In fact, if the non-repudiating party chooses to treat the repudiation as a material breach, then that party's duty to perform his own duty will actually be discharged. This important effect will be discussed further in Section 9.6c, below.

It appears that some courts have said that if the non-repudiating party has already fully performed his own duties under the contract, then that party must wait for the time at which the repudiating party's duty would normally be due to bring a lawsuit for breach of contract. Of course, that would really mean that innocent party would be forced to wait until the repudiating party actually breached the contract by failing to perform when that repudiating party's duty to perform would normally have been due. So in that situation, the repudiating party would have the opportunity to change his mind and perform, up until the time his performance was due. However, it is not clear how widespread this exception is. For example, the Uniform Commercial Code in the United States says the non-repudiating party may treat the repudiation as a breach and bring a lawsuit immediately in all cases involving sale of goods contracts.

In any case, the non-repudiating party generally has the following four options when an anticipatory repudiation occurs:

(1) stop his own performance, treat the anticipatory repudiation as a material breach and ask a court for remedies such as money damages immediately;

(2) stop his own performance and wait until the repudiating party's duty would normally be due to ask a court for remedies;

(3) stop his own performance, treat the repudiation as an offer to rescind the contract and simply treat the contract as discharged (ended);

OR (4) urge the repudiating party to perform and wait to see if he does perform before bringing any lawsuit.

If a non-repudiating party treats an anticipatory repudiation as a breach and asks a court for remedies because of the repudiation, that party must show the court that he could have performed the contract if the other party had not repudiated. In other words, the non-repudiating party

must show that he was willing and able to perform his duties under the contract at the time they were due.

For instance, in the peanut example above, if Sann decided to bring a lawsuit against Chamrath for breach of contract because of Chamrath's anticipatory repudiation, Sann would have to show the court that Sann could have delivered the peanuts according to the contract in order to get a remedy on the basis of the contract. If Sann could not show this, he would not be able to recover. For example, if Sann actually could not have gotten any peanuts to sell and could not have performed the contract even if Chamrath had not repudiated, then Sann could not recover in a lawsuit against Chamrath.

Of course, if Sann received the repudiation from Chamrath and later made a different contract to sell the peanuts to Sathya, that would not prevent Sann from recovering for the breach. The reason is that Sann's new contract in that situation would actually be an effort to avoid (or "mitigate") the damages he would suffer because of Chamrath's breach. In fact, courts generally say that parties cannot recover damages that they could reasonably have avoided.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies"), Section 10.6c contains further discussion of the important rule that parties to contracts cannot recover for damages that they could reasonably have avoided.

*** ***CASE STUDY 203***

FACTS Bayon Airlines decided that it needed a new airplane to meet the growing demands of its passengers, who wanted to fly all over Cambodia all the time. So Bayon contacted the Blue Sky Aircraft Corporation and ordered a new plane. The parties signed a contract stating that Bayon would pay $3,000,000 to Blue Sky three months after the contract was signed, and that Blue Sky would deliver the plane to Bayon within 10 days after receipt of the money.

Unfortunately, several weeks after the parties signed their contract, Blue Sky sent Bayon an electronic mail message stating that it did not think it would be able to fill Bayon's order for the plane, because there might not be any of the right kind of plane available until the following year! The president of Bayon was furious, and she sent an e-mail to the president of Blue Sky demanding to know whether it would deliver the plane or not. One week later, Blue Sky notified Bayon that it would not deliver the type of plane Bayon had ordered. However, Blue Sky said it had several of its larger $5,000,000 planes available, and it would be happy to sell Bayon one of those.

The president of Bayon is not sure what to do. She does not need a $5,000,000 plane. She asks her lawyer what the legal status of the contract is, and what her options are.

QUESTION OF LAW What is the legal status of the contract between Blue Sky and Bayon, and what options does Bayon have?

DECISION Blue Sky has made an anticipatory repudiation of this contract. When the repudiation occurred, the condition on which Blue Sky's duty to deliver the plane depended--Bayon's payment of $3,000,000--was excused by Blue Sky's repudiation. Bayon now has several options, including: stopping its own performance, treating the repudiation as a material breach and asking a court for a remedy immediately; or stopping its performance, treating the repudiation as an offer to rescind and treating the contract as discharged.

When one party makes an anticipatory repudiation of a contract duty, that repudiation excuses any conditions on which that duty depended, and the duty will become due for performance even though the conditions have not been fulfilled. An anticipatory repudiation occurs where one party makes a clear statement that he will not perform according to the contract in the future when his performance is due. Where one party repudiates, the other party has several options, including stopping his own performance, treating the repudiation as a breach and asking a court for an appropriate remedy; or stopping his own performance, treating the repudiation as an offer to rescind and treating the contract as discharged.

In this case, Bayon's duty to pay $3,000,000 was probably an implied-in-law condition precedent to Blue Sky's duty to deliver the plane, since the contract said that the payment was to occur first. However, Blue Sky made two statements to Bayon long before either of the performances was due. First, Bayon said that it did not think it would be able to deliver the plane. This statement was not an anticipatory repudiation, because it merely showed doubt; it did not clearly state that Blue Sky would not perform. However, Blue Sky's next statement was that it would not deliver the plane. This statement was clear, and it was an anticipatory repudiation. Blue Sky's anticipatory repudiation means that its duty to deliver the plane will become due even though the condition on which that duty depended--Bayon's payment of $3,000,000--has not been fulfilled. This is because Blue Sky's repudiation excused the condition.

The repudiation means that Bayon has several options. First, Bayon may stop its own performance, treat Blue Sky's repudiation as a material breach of the contract, and immediately ask a court for a remedy. Second, Bayon may stop its own performance and wait until Blue Sky's duty would normally be due to ask a court for remedies, which in this case would be no later than three months and ten days from the contract date. Third, Bayon may stop its own performance, treat the repudiation as an offer to rescind the contract, and treat the contract as discharged. Fourth, Bayon may choose to urge Blue Sky to perform and wait to see if Blue Sky performs before bringing any lawsuit. In this case, it seems unlikely that Blue Sky will perform. Bayon might be wise to simply treat the contract as discharged. But if Bayon

had damages that would make a lawsuit worthwhile, it could treat the repudiation as a material breach, and immediately ask a court for a remedy such as money damages to compensate Bayon for Blue Sky's breach. If Bayon does wish to recover in a lawsuit, it should take reasonable efforts to avoid unnecessary damages, probably by getting a comparable plane from another aircraft supplier.

A party who repudiates a contract duty may retract his repudiation up until the time his performance would normally be due under the contract unless the non-repudiating party has:

(1) accepted the repudiation; or

(2) detrimentally relied on the repudiation.

A party has accepted a repudiation if that party has somehow indicated that he considers the repudiation final and does not wish to proceed with the contract. For example, filing a lawsuit for breach of contract would probably show that a party considered a repudiation final.

A party has detrimentally relied on the repudiation if he has somehow changed his position in reliance on the repudiation and it would be unfair to the non-repudiating party to allow the repudiating party to retract. Detrimental reliance was discussed in detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.8, which explained promissory estoppel. In this kind of situation, it appears that courts basically treat the statement of repudiation as a promise not to perform; if the other party detrimentally relies on that statement, then the non-repudiating party will be compensated for the effects of the statement as justice requires, as with promissory estoppel.

For instance, in the peanut example above, Chamrath could actually retract his repudiation and go forward according to the contract unless Sann had accepted or detrimentally relied on the repudiation. So if Sann received the repudiation and did nothing, and Chamrath sent a note soon afterwards saying "I retract, and I will perform our contract," then the repudiation would be retracted and the contract would be as it was before. But if Sann responded to the repudiation by saying "fine, the contract is canceled," Sann would have accepted the repudiation, and Chamrath could not retract it. Or if Chamrath did make a new contract to sell the same peanuts to Sathya in order to avoid damages, Sann would have detrimentally relied on the repudiation by making a new obligation to do something else with the peanuts. In that situation, it might be unfair to allow Chamrath to retract his repudiation and enforce the contract against Sann, because Sann might not be able to meet both obligations. So Chamrath might not be permitted to retract.

*** ***WHY IS THIS IMPORTANT?*** Why does an anticipatory repudiation of a contract duty excuse any conditions on which that duty depends, and give the non-repudiating party the option to treat the repudiation as a breach and ask a court for a remedy immediately?

An anticipatory repudiation excuses conditions, and gives the non-repudiating party the option to seek a remedy immediately, because it could be very unfair to the non-repudiating party to force him to fulfill a condition when he knows that the other party will not perform. In addition to causing the non-repudiating party unnecessary trouble, it might be difficult, as a practical matter, to recover the consideration the non-repudiating party provided. This is because it might require a court order, which could be difficult and time-consuming to get and to enforce. In addition, it might cause the non-repudiating party damage he could not recover in court, because it might cause him damage he could reasonably have avoided! Damages might increase because the non-repudiating party did not have the use of his money or other consideration during the time it was in the repudiating party's possession. It might also interfere with the non-repudiating party's ability to find another party with whom to contract, which is a common way to avoid unnecessary damages. And of course, it could waste the court's (or arbitrator's) time and resources, by creating a problem that need not have been created: how to get the non-repudiating party's consideration back to him. In fact, some of the options the non-repudiating party has--such as simply treating the contract as discharged--may not involve courts or arbitrators at all.

For example, in Case Study 203, if Bayon was forced to pay Blue Sky the $3,000,000 even though it knew Blue Sky would not perform, it would be a waste of Blue Sky's time and money. The damages would grow larger, since Bayon would not have the use of the $3,000,000 (and could not earn interest or other income on the money) for the time Blue Sky had the money. Bayon might have difficulty getting the money back. If Bayon had to pay the $3,000,000 to Blue Sky on schedule, it might also interfere with Bayon's ability to find another aircraft manufacturer to sell it a plane. Finally, it might waste some of the courts' time if they had to resolve a matter--how to get Bayon's money back to Bayon--that need never have come before the courts. Basically, forcing Bayon to go through with this contract could create legal and economic waste.

9.4e The Prospective Inability or Unwillingness to Perform of the Party Whose Duty Depends on a Condition May Excuse the Condition

Sometimes it appears that a party will not be able or willing to perform a contract duty, even if there has been no clear statement creating an anticipatory repudiation. When circumstances provide a reason to believe that it is unlikely that a party will be able or willing to perform a contract duty, that party may have a prospective inability or unwillingness to perform. If that happens, any condition on which that duty depends will be excused.

*** **DEFINITION:** A **prospective inability or unwillingness to perform** exists where circumstances provide a reason to believe that it is likely that a party will be unable or unwilling to perform a contract duty.

Where there is a prospective inability or unwillingness to perform a contract duty, the inability or unwillingness excuses any conditions on which that duty depends. So the duty to perform becomes due for performance even though the condition has not been fulfilled.

For example, suppose Chhorn and Leng agree that Chhorn will buy Leng's bicycle, and that delivery will occur in three days. If Leng sells his bicycle to Sokha on the day after the contract is made, that act creates a prospective inability to perform the contract with Chhorn. That is because it creates a reason to believe that it is unlikely that Leng will be able to perform the contract. This is true even though Leng has made no statement to Chhorn, and even though it is not certain that Leng will be unable to perform, since he could possibly buy the bicycle back from Sokha before his duty to supply the bicycle to Chhorn is due. In this situation, where Chhorn's payment for the bicycle is an implied-in-law condition concurrent to Leng's duty to provide the bicycle to Chhorn, the condition is excused by Leng's prospective inability to perform. So Chhorn is no longer required to provide his own performance in order to cause Leng's duty to provide the bicycle to become due.

One of the most important things to understand about prospective inability or unwillingness to perform is how it differs from anticipatory repudiation. This appears to be a difficult issue, about which even courts and legal authorities do not always agree! It seems that the most basic difference is that an anticipatory repudiation is a clear statement by one party that he will not perform, whereas a prospective inability or unwillingness to perform results from any circumstances that create a reason to believe that it is unlikely that a party will perform.

Prospective inability or unwillingness to perform is judged by an objective, "reasonable person" standard. That means that it exists where a reasonable person would believe that it is unlikely the other party will perform. So in order for prospective inability or unwillingness to exist, no statement from the other party is required, and it need not be clear that the other party will not perform.

In fact, it appears that the circumstances showing prospective inability or unwillingness to perform are usually something other than statements by the party who may not perform. One example would be the bicycle example above, where Leng made no statement to Chhorn, but Chhorn learned of circumstances that showed it was unlikely Leng would perform. Another example might be the situation where a money lender learns information about a debtor that shows it is unlikely that the debtor will be able to repay a debt--even though there has been no statement from the debtor to the lender. In these situations, the circumstances surrounding the contract might show prospective inability or unwillingness of one party to perform a contract duty. If the circumstances showed that, it would excuse any condition on which the duty depended.

However, it also appears that prospective inability or unwillingness to perform may result from statements by a party that give reason to believe that it is unlikely that he will perform. Such statements would not need to be strong or clear enough to be anticipatory repudiations. But they would probably have to be stronger than the four examples in Section 9.4d of statements that would be too weak to be anticipatory repudiations, such as "this contract may be difficult for me to perform." In other words, the examples in Section 9.4d would probably be too weak to create anticipatory repudiations and too weak to show prospective inability or unwillingness to perform.

In order to create a prospective inability or unwillingness to perform through statements, it would seem that a party would have to make statements that were as strong as "I doubt very much that I can perform," or "it is unlikely I can perform." Obviously, the main difference is in how clear it is that the party making the statement will not perform. The following chart tries to illustrate this distinction.

Illustration: Statements Creating Anticipatory Repudiation vs. Statements Showing Prospective Inability or Unwillingness to Perform

What Statement Basically Says about Performance:

Clearly Will Not Occur →	**Unlikely to Occur** →	**May Not Occur**
Anticipatory Repudiation	**Prospective Inability or Unwillingness to Perform**	**Probably neither One**
"I will not perform."	"I doubt very much that I will perform."	"I have some doubt about whether I will perform."
"I cannot perform."	"There is almost no way I can perform."	"It will be difficult for me to perform."
"I have no intention of delivering the goods."	"It's unlikely that I will deliver the goods."	"I am not sure about delivering the goods."

One important effect of prospective inability or unwillingness to perform a contract duty is that it excuses any condition on which that duty may depend, as noted above. This means that the condition need not be fulfilled in order for the performance of the duty which depends on it to become due.

In addition, if that condition is actually the performance of a party, the other party may stop his own performance and wait to see if the party whose performance is uncertain performs or not. And it appears that some jurisdictions actually say that the party who may be harmed by a prospective inability or unwillingness to perform may not only stop his performance,

but may also treat the inability or unwillingness as a material breach and sue for breach of contract! However, it appears that other courts say the party who may be harmed must wait for the time the uncertain performance is due to bring such a lawsuit. That might be a better rule in a situation where it is not clear whether a party will perform or not. If a party could terminate a contract merely because he had reason to believe that the other party's performance was unlikely, it might result in the cancellation of contracts--and in costly litigation--in situations where those events were not necessary.

Another effect of prospective inability or unwillingness under laws in many jurisdictions (such as the Uniform Commercial Code in the United States) is that the party who is concerned about the other party's performance may request adequate assurances from the party whose performance appears unlikely. In fact, laws like the Uniform Commercial Code allow a party to request such assurances where there is reason to doubt whether the performance will occur--which would occur in far more situations than those where there is a reason to believe performance is unlikely. It appears that not all assurances are "adequate," and that an unconvincing assurance would not meet this standard. For example, a mere statement by a party that he is willing and able to pay money may not be enough. Some proof of assets (such as a bank statement) might be required.

Where a party has a right to request assurances of performance and that party does request them, a failure by the other party to give adequate assurances may actually convert the prospective inability or unwillingness into an anticipatory repudiation! This is because some laws say that the party whose performance seems unlikely has a limited time to provide adequate assurances before his failure actually becomes a repudiation. For example, under the Uniform Commercial Code, these assurances must be given within a reasonable time, which is not to be longer than 30 days. In fact, in some circumstances, a reasonable time might be much less than 30 days.

For instance, in the bicycle sale example above, when Chhorn learned that Leng had sold the bicycle to someone else, many jurisdictions would say Chhorn had the right to request adequate assurances that Leng would perform the contract. If Leng failed to provide such assurances within a reasonable time--which in this situation might be as short as a few hours--then Leng's prospective inability to perform would actually become an anticipatory repudiation! In that case, Chhorn would have all the options discussed in Section 9.4d above, including the right to treat the repudiation as a material breach and immediately bring a breach of contract lawsuit.

******* ***CASE STUDY 204***

FACTS A real estate investment company named Chantou and Associates agrees to buy a large piece of land in the center of Stung Treng from Sophal. The parties sign a contract on October 2 in which they agree that the price

will be 20,000,000,000 riels, and that the parties will exchange the land title and the money on December 1.

In late October, Sophal hears rumors that Chantou's company has been having serious financial trouble. She calls Chantou on the telephone, but learns that Chantou's phone has been turned off for non-payment. Then she hears that Chantou's company has filed for bankruptcy protection! Sophal becomes very worried about whether Chantou's company will honor the contract. In fact, Sophal is especially anxious to know because she has found another potential buyer named the Queen Group. The Queen Group is also willing to pay 20,000,000,000 riels for the land, but only if it can obtain title no later than November 21--10 days earlier than Sophal has agreed to transfer the land to Chantou's company.

Sophal writes a letter to Chantou's company demanding to know whether it will perform its duties under the contract. The letter notes that Sophal has another potential buyer who will agree to buy the land if it can get title no later than November 21. On November 1, Sophal has the letter hand delivered to Chantou's last known business and home addresses. Sophal never receives a reply to her letter. On November 15, Sophal delivers another letter to Chantou stating that she is treating Chantou's failure to respond as an anticipatory repudiation. On November 17, Sophal agrees to sell the land to the Queen Group, which she does. On December 15, Chantou's lawyer calls Sophal to say that Sophal has breached the contract with Chantou's company!

QUESTION OF LAW Did Sophal have any obligation to transfer the land in this contract to Chantou's company on December 1?

DECISION No. Sophal had no obligation to perform under this contract because the circumstances in this case showed a prospective inability to perform, followed by an anticipatory repudiation by Chantou's company.

Where circumstances give reason to believe that a party to a contract is unlikely to perform a contract duty, there is a prospective inability or unwillingness to perform, and any condition on which that duty depends will be excused. And in many jurisdictions, if the party who may be harmed by such non-performance requests adequate assurances, but fails to receive them, then there is an anticipatory repudiation.

In this case, Sophal's duty to transfer the land title on December 1 was an implied-in-law condition concurrent to Chantou's duty to pay the 20,000,000,000 riels, since both performances could occur at roughly the same time. However, Sophal had reason to doubt whether Chantou's company would perform the contract--particularly because of the apparent bankruptcy of Chantou's company. In fact, these circumstances gave Sophal reason to believe that it was unlikely that Chantou's company would actually perform the contract with Sophal. So there was a prospective inability to perform. This excused the condition to Chantou's duty to pay, and meant that Sophal

was not required to transfer the land to Chantou in order for Chantou's duty to pay to become due.

However, in this case, Sophal did not wish to wait to see if Chantou really would perform. She had another potential buyer for the land--the Queen Group--which was ready to pay the same price, as long as it could get the land title no later than November 21. Of course, this date was earlier than December 1, the performance date of the contract between Sophal and Chantou.

So Sophal decided to request adequate assurances that Chantou would perform her contract duties. Sophal requested those assurances on November 1, but she received no reply from Chantou within a reasonable time. A reasonable time would probably be less than the 16 days Sophal waited, because of the urgent nature of the other potential contract with the Queen Group.

In fact, Chantou's failure to give adequate assurances converted the prospective inability to perform into an anticipatory repudiation, and gave Sophal all the options explained in Section 9.4d, above. One option Sophal had was the option to treat the repudiation as an offer to rescind, and treat the contract as discharged. This may be what Sophal did here, since she made a new contract with the Queen Group, but did not file a lawsuit against Chantou's company for any remedy. However, if Sophal did wish to bring a breach of contract action to get a remedy for any damage caused by Chantou's breach, Sophal would be entitled to do so. Of course, Sophal has done such a good job at avoiding damage--by selling the land immediately to another buyer at the same price--that she may not have suffered much damage.

*** ***WHY IS THIS IMPORTANT?*** Why do laws in some jurisdictions say that parties may seek adequate assurances where there is a prospective inability or unwillingness to perform, and that failure to receive such assurances may actually convert that apparent inability or unwillingness into an anticipatory repudiation?

The reason laws in some jurisdictions provide this mechanism appears to be to give a party who might be harmed by such a prospective inability or unwillingness more options, and more power to protect his interests. Basically, this mechanism gives parties in such uncertain situations the power to find out more definitely whether the other party actually will perform or not! If the other party gives adequate assurances, then the first party has at least some more confidence that the contract will be performed. If the other party fails to provide such assurances, then there is a repudiation. In that case, the first party has many options to protect himself, including treating the repudiation as a material breach and immediately asking a court for remedies, as discussed in Section 9.4d. So a party in this situation need not take the risk of providing his own performance without knowing if he will receive anything in return, or the risk of waiting for the other party to actually breach before

bringing a lawsuit for breach of the contract. Providing this option promotes better clarity in the performance of contracts.

In addition, this option appears to promote economic efficiency. That is because it provides parties who fear that another party will not perform with a better way to avoid damage. For example, it could give such parties more confidence that they can make another contract to substitute for the one that is unlikely to be performed. The sooner parties get this knowledge, the better they can avoid unnecessary damage.

As with anticipatory repudiation, a party who is prospectively unable or unwilling to perform may be able to fix or "retract" his inability or unwillingness to perform. In other words, if the party manages to fix whatever problem led to the prospective inability or unwillingness to perform, then he may be able to reinstate the condition and continue with the contract. In order for that to occur, the party's new ability or willingness must somehow be communicated to the other party. If that occurs, then any conditions on which the retracting party's duties depend will not be excused, and the other party must resume his performance. However, as with anticipatory repudiation, if the party whose performance is not in doubt has detrimentally relied on the prospective inability or unwillingness in a substantial way, then the prospective inability or unwillingness cannot be fixed. If the party only relied in a minor way, such as by merely stopping preparations for his own performance, that party might be given a reasonable amount of additional time to fulfill the condition.

For example, in Case Study 204 above, Chantou's company might have been able to continue with the land sale contract if it could somehow have overcome its prospective inability to perform and that fact was communicated to Sophal. This might have occurred if Chantou was having some financial difficulties, but the rumors about bankruptcy were not true, and she was able to find loans to meet her company's obligations. However, once Sophal had detrimentally relied on the prospective inability--in this case by failing to receive the adequate assurances she requested and making the new contract with the Queen Group--Chantou's company would not be able to overcome its prospective inability and continue with the contract. By contrast, if Sophal's reliance was only that she did not prepare the land to be transferred according to the contract, Chantou might still be able to continue with the contract. In that case, Sophal might be given the additional time required in order to perform her contract duties, and to fulfill the condition concurrent to Chantou's duties.

The following chart compares some of the important aspects of anticipatory repudiation and prospective inability or unwillingness to perform.

Illustration: Anticipatory Repudiation vs. Prospective Inability or Unwillingness to Perform

	Anticipatory Repudiation	Prospective Inability or Unwillingness to Perform
1. What is it?	A clear statement by a party that he will not perform a contract duty	Situation where circumstances give reason to believe that it is unlikely a party will perform
2. How certain must it be that party will not perform?"	A clear statement is required	It must appear unlikely to a reasonable person that the party will perform
3. What is the legal effect?	Conditions excused; party harmed may stop his own performance, treat as breach and sue immediately, or choose other options	Conditions excused; other party may stop his own performance; some courts allow lawsuit for contract breach immediately
4. Is retraction or reinstatement of contract possible?	Yes, unless other party has accepted repudiation or detrimentally relied	Yes, unless other party has detrimentally relied
5. What are the main differences?	(a) Must be clear statement that repudiating party does not intend to perform	(a) Circumstances provide reason to believe it is unlikely that party will perform
	(b) Excuses conditions and allows immediate lawsuit for breach, among other options	(b) Excuses conditions (some courts allow immediate lawsuit for breach)

9.4f The Failure or Occurrence of a Prior Condition May Excuse a Condition

Sometimes a contract duty depends on one condition, and the occurrence of that condition actually depends on the occurrence of another condition! In that situation, if the earlier condition does not occur, then the later condition might be excused, and the duty which depends on that later condition might become due for performance--even though the later condition has not occurred.

For example, suppose a banana seller agrees to sell "the 1,000 of Seller's bananas that Buyer chooses" to a certain banana buyer. Courts would say that each party's duty to perform (provide bananas or money) would be subject to the implied-in-law condition concurrent that the other party perform (provide bananas or money), since both of those performances could occur roughly simultaneously. However, in this case, the banana seller's duty

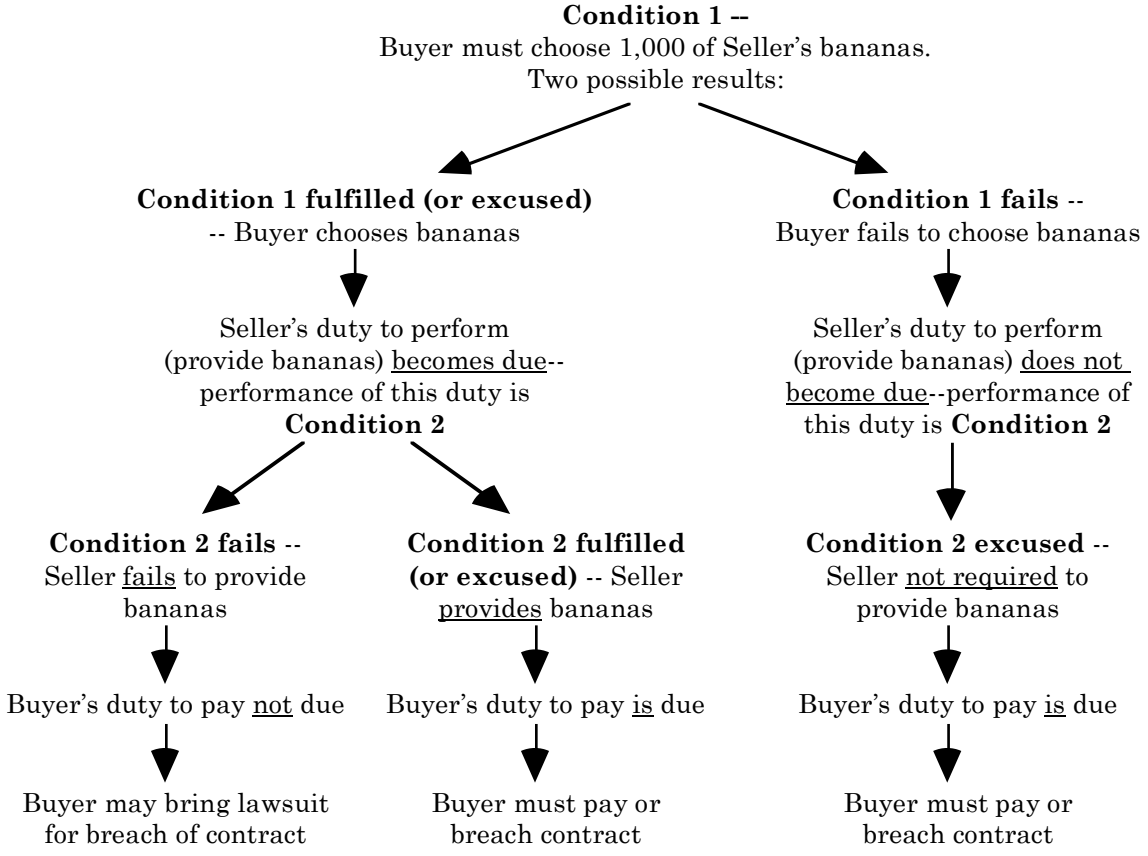
to perform would also be subject to an implied-in-fact condition precedent: the buyer's actually choosing the particular 1,000 bananas he wanted! So if the buyer failed to select those 1,000 bananas, that implied-in-fact condition would not occur. In that case, the condition concurrent that was the banana seller's performance would be excused--since he could not provide bananas of the buyer's choice if he did not know what that choice was. So the banana buyer's duty to perform would become due even though the condition concurrent on which it depended had not been fulfilled. The buyer would be required to perform. If the buyer did perform--and selected the bananas--then the seller would also have to perform, or breach the contract. But if the buyer did not perform, then the buyer would breach the contract.

There might be a similar result if the occurrence of one condition actually depended on the non-occurrence of a different condition subsequent. In that situation, the occurrence of the condition subsequent would actually terminate the duty of performance that depended on it. If that performance was also a condition to some other duty, then that condition would be excused, and the other duty would become due for performance. However, for ease of discussion, this Section will focus on the failure of conditions precedent and concurrent.

The situation where a condition may be excused by failure of a prior condition to occur is illustrated in the chart below.



Illustration: Example of How a Condition May Be Excused by Failure of a Prior Condition to Occur



*** ***CASE STUDY 205***

FACTS In March, Sokhun and Vitah make a construction contract under which Vitah agrees to build four new homes on a large piece of property Sokhun owns. The property is in a very low-lying area. Under the contract, construction is to begin in May. The contract also says that the new homes will be "built on specific sites to be designated by Sokhun."

Vitah has trouble getting Sokhun to tell him the exact sites on which the homes are to be built. Finally, August arrives, and Sokhun has still not designated the sites on which the homes are to be built. Meanwhile, rainy season has also arrived, and Sokhun's land is so badly flooded that construction cannot begin until the end of the year! Vitah tells Sokhun that his construction crews will not be available at the end of the year, and that he is suing Sokhun for breach of contract. Sokhun says he could not have breached the contract, because his duty to pay was subject to the condition precedent that Vitah build the homes, and Vitah never did that.

QUESTION OF LAW Has Sokhun's duty to pay become due?

DECISION Yes. The implied-in-law condition precedent to Sokhun's duty to pay--that Vitah build the homes--was a performance that was itself subject to the implied-in-fact condition precedent that Sokhun designate the specific sites for the homes. Since the "designating" condition did not occur, the "building" condition precedent to Sokhun's duty to pay was excused, and Sokhun's duty to pay became due.

Where one condition depends on the occurrence of another condition, and the earlier condition fails, then the later condition is excused, and the duty that depends on it becomes due for performance. In this case, Sokhun's duty to pay for the construction of the homes depended on the implied-in-law condition precedent that Vitah actually build the homes, since the construction would take a substantial amount of time to complete and the payment could occur quickly. However, Vitah's duty to build the homes depended on the implied-in-fact condition precedent that Sokhun actually show Vitah where to build the homes. This is because Vitah could not build the homes "on specific sites to be designated by Sokhun" unless Sokhun actually designated the sites! Here, Sokhun failed to do that before rainy season, making it impossible for Vitah to build the homes according to the contract. So the condition precedent to Vitah's duty to build the homes never occurred, and that duty never became due. Since Vitah's duty to build never became due, the condition precedent to Sokhun's duty to pay--the construction--was actually excused. So Sokhun's duty to pay became due even though the homes were not built. Sokhun's behavior could also be analyzed as a wrongful prevention or hindrance, or as a violation of the duty of good faith and fair dealing, which are discussed in later Sections.

In any case, in this situation, Vitah's duty to build the homes has not become due. And Vitah has a claim for breach of contract against Sokhun because of Sokhun's failure to perform according to the contract. Of course, Sokhun is not required to pay the entire contract price even though he has received nothing under the contract. A court would probably award Vitah a remedy such as what Vitah lost by not being able to perform the construction work, if that could be determined with reasonable certainty.

9.4g An Improper Rejection of a Tender of Performance May Excuse a Condition

Sometimes one party properly tenders performance to another party, but that tender is rejected. When that occurs, and the rejected performance is also a condition to some duty, the improper rejection of the tender excuses the condition. So the duty that depended on that condition becomes due, even though the condition has not been fulfilled.

*** **DEFINITION:** A **tender of performance** is basically a party's offer to perform his existing contract duties, with the present ability to do so.

In this situation, an "offer" is not the same as the "offers" discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"). In this situation, an "offer" to perform means some indication that a party is ready to perform his existing contract duties.

As explained above, a rejection of a proper tender of performance will excuse a condition, and cause the other party's duty to become due. This means that a party can cause the other party's duty to become due merely by properly offering performance according to the contract, while giving some indication that the party has the ability to perform--even if the other party rejects that offer! A rejection of a tender is basically a refusal to accept what is offered.

For example, suppose a seller in a land sale contract properly tenders performance by offering to transfer the land title and provide any other required documents to the buyer, with the present ability to complete that transfer. If the buyer rejects that tender by refusing to accept the title, the condition concurrent to the buyer's duty to pay for the land--which is the seller's performance of his duty to transfer the property--is excused. Because that condition is excused, the buyer's duty to perform by paying for the land becomes due. If the buyer does not pay the money due under the contract, the seller may file a lawsuit for breach of contract.

Although rejection of a tender of performance can occur in many situations, it appears that this rule is particularly important where conditions concurrent exist, especially in sale of goods and sale of land contracts. This appears to be because rejection of a tender is most likely to occur in situations where conditions are also performances that can be accomplished quickly, generally by presenting something to another party. In fact, some of the rules about how an improper rejection of a tender of performance may excuse conditions were already discussed in Section 9.3b, which explained conditions concurrent.

As part of this rule, courts must determine what is a proper tender of performance. Obviously, not all tenders are proper, and parties are not required to accept tenders that are not proper. In general, a proper tender is an offer to perform with the present ability to do so as required by the contract. In other words, a proper tender is generally an offer to perform in a way that would actually fulfill a condition, either through complete performance, or substantial performance, if that is permitted.

However, there are also some special rules about what is a proper tender in some jurisdictions. For example, it appears that many jurisdictions say that a proper tender of money must generally be in cash (currency), rather than by check or some other means. And many jurisdictions also have particular rules about what is a proper tender in specific types of contracts, such as the rules about what is a proper tender of goods in a sale of goods contract. Some laws like this generally require a seller of goods to tender

complete performance--with no non-conformities--in order to make a proper tender, or else the buyer has the right to reject the goods. Some of these special rules will be discussed in detail in Section 9.5b, below.

It is also possible for a party to "waive" his right to claim that a condition was not fulfilled because of an improper tender. To "waive" a right is basically to knowingly give up that right. This difficult area will be discussed more fully in Section 9.4i below, but a few general rules follow. If a party waives his right to insist that a condition occur, then that condition is excused, and the party cannot later claim that his duty did not become due because the condition was not fulfilled. Where a tender is not proper, it appears that a party may waive the right to claim that a condition has not been fulfilled either expressly, or impliedly by merely continuing his performance of the contract or accepting benefits under the contract. A waiver of a problem in a tender could occur where a party accepts a tender, but later claims there is some problem with the tender. Or it could occur where a party rejects a tender for one reason, then later says he also rejected the tender for a different reason! In general, a waiver will occur following a rejection only if the rejecting party knew or should have known of the problem about which he failed to complain, and the other party would have been able to fix the problem if he had been told of it. However, even if a party waives his right to claim that a problem in tender prevented a condition from being fulfilled, that party does not waive his right to a remedy for any breach of contract caused by the problem, unless the waiver is part of an enforceable modification of the contract. Excuse of conditions because of waiver will be discussed in more detail in Section 9.4i, below.

One important effect of an improper rejection of a tender of performance is to excuse any condition which consisted of that performance, and to cause any duties that depended on that condition to become due. If the rejecting party does not perform the duties, then the other party may file a lawsuit for breach of contract. Another possible effect of such an improper rejection is to actually discharge the duty to provide the performance that was tendered and improperly rejected. However, that only occurs in particular situations. Those situations will be discussed in Section 9.6d, below.

******* ***CASE STUDY 206***

FACTS A farmer named Vannay decided to buy a tractor in order to improve the operation of her farm. She made a contract with a merchant named Souley to buy a tractor for $5,000, with delivery to occur in a week.

A week later, Vannay came to see Souley and tried to give him $5,000 in cash for the tractor. But Souley refused to accept the money, saying it was not enough! Souley also said that Vannay had not actually performed her duty of paying him the money, so any duty he might have to provide the tractor had not become due. Vannay asks the court for help.

QUESTION OF LAW Has Souley's duty to provide the tractor become due?

DECISION Yes. Souley's duty to provide the tractor has become due because Souley improperly rejected Vannay's tender of the $5,000, and this excused the condition concurrent to Souley's duty to provide the tractor.

Where a party improperly rejects a tender of a performance which is also a condition, that rejection excuses the condition, and the duty that depends on that condition becomes due. In this case, Vannay's duty to pay Souley $5,000 was an implied-in-law condition concurrent to Souley's duty to provide the tractor. Vannay made a proper tender of performance of her duty to pay the $5,000 by offering Souley the money in cash at the time the parties had agreed. But Souley rejected this tender. This improper rejection excused the condition concurrent on which Souley's duty to provide the tractor depended, and it caused that duty to become due for performance. If Souley does not perform, Vannay's duty to perform will not become due. In that situation, Vannay may also file a lawsuit for breach of contract because of Souley's failure to keep his promise.

9.4h Wrongful Prevention or Hindrance by the Party Whose Duty Depends on a Condition May Excuse the Condition

Sometimes a party whose duty depends on a condition wrongfully stops the condition from occurring, or makes its occurrence very difficult. Often, this happens where one party actually prevents or hinders the performance of the other party. When a party wrongfully prevents or hinders the occurrence of a condition, that condition is excused, and the duty that depends on the condition becomes due for performance. It appears that the wrongful actions need not actually prevent the condition from occurring, but that a condition may be excused if a party has merely made the condition very difficult to fulfill.

These excuses are somewhat comparable to the doctrines of impossibility and impracticability, although impossibility and impracticability occur because of events that are not the actions of the parties themselves. Impossibility may excuse conditions, as discussed in Section 9.4j below. And impossibility and impracticability may discharge duties, as discussed in Section 9.8a below.

For example, suppose Samy agrees to take care of Bunchin for the rest of Bunchin's life, in exchange for Bunchin's promise to leave all of Bunchin's property to Samy when Bunchin dies. Samy's caring for Bunchin for the rest of his life would be a condition precedent to Bunchin's duty to leave Samy the property. But suppose Bunchin wrongfully prevented Samy from fulfilling that condition--perhaps by throwing Samy out of the house and telling him never to come back! In that case, the condition would be excused, and Bunchin's duty to leave Samy the property would become due. Of course, many courts would be unlikely to order Bunchin to actually transfer

all his property to Samy at Bunchin's death--and to have Samy continue caring for Bunchin until that time--because of the difficulties that might be involved in performing and enforcing such an order. Instead, a court might try to find some other fair way to compensate Samy for the breach, using the methods described in Chapter 10 ("Remedies").

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains further discussion of what courts might do when there is a breach of contract.

The most important requirement for prevention or hindrance to excuse a condition is that the prevention or hindrance must be wrongful. What is "wrongful" is difficult to define, and it will vary in different circumstances. However, it appears to be conduct that unjustifiably prevents or hinders the other party's performance under the contract.

One factor many courts say is important in determining whether such conduct is wrongful is that the other party did not assume the risk of that type of conduct occurring at the time the contract was made. For instance, in the example above, Samy probably did not assume the risk that Bunchin would make Samy's performance impossible by simply ordering him to leave the house forever. However, if Samy claimed that Bunchin had forced him to leave merely by behaving strangely--even though Samy had known Bunchin well and observed such behavior before the contract was made--a court might say that Bunchin had assumed the risk of that type of behavior in making the contract.

Courts also say that buyers and sellers of goods generally assume the risk that their performance will be hindered due to a change in the market supply or price of such goods before the time for delivery--including the risk that the other party to the contract will actually cause this change! So that kind of a change generally will not excuse a condition. However, it appears this general rule may not apply if that change actually prevents performance--especially if the other party causes the change knowing the effect it will have on the first party.

For example, suppose one party agrees to buy a particular kind of steel from another party. Suppose the buyer then buys so much of this kind of steel from other sources that the supply of the steel becomes very limited, and the price rises drastically! Of course, this could greatly hinder the seller's performance of the contract, by making it difficult for him to obtain the steel at a reasonable price. But as discussed above, many courts would say that the seller assumed the risk that the market would change in this way. So the courts would say that the condition concurrent to the seller delivering the steel would not be excused. However, it seems that if the buyer knew that he was eliminating the seller's only source of supply of that type of steel, then courts would be likely to find the buyer's behavior wrongful, and to say that the condition to the buyer's duty to pay was excused. This kind of

assumption of risk will be discussed further in Section 9.8a, which explains impossibility and impracticality.

An improper rejection of a tender of performance might also be viewed as a wrongful prevention or hindrance. This is because such a rejection would really be a kind of prevention of the tendering party's performance! For example, it seems that Souley's improper rejection of Vannay's tender of the money in Case Study 206 would probably meet the requirements for a wrongful prevention. So the condition to Souley's duty to provide the tractor could probably be excused on that basis, in addition to the basis that it was an improper rejection of a tender. Improper rejection of a tender of performance was discussed in Section 9.4g, above.

*** ***CASE STUDY 207***

FACTS The De-mining Foundation wanted to get some special, complex de-mining equipment manufactured. So the Foundation and the Special Equipment Company agreed that the Company would manufacture 100 sets of the special equipment for a certain price. The contract said that the Foundation would have "no duty to pay for the equipment unless it was delivered no later than four months after the contract date." The contract also said that the Foundation would actually supply designs and some of the raw materials for the special equipment, since the Foundation had special needs and plans for its use.

Unfortunately, the Foundation had some trouble getting the plans and materials to the Special Equipment Company. In fact, the Special Company received one set of plans two months after the contract date, and received a conflicting set of plans two weeks after that! The conflicts took another week to resolve. In addition, the Special Company did not receive the raw materials from the Foundation until three months after the contract date. In these circumstances, the Special Company was prevented from completing the work by the time it was due under the contract, despite diligent efforts to do so.

When the finished de-mining equipment finally arrived--late--the Foundation refused to accept or pay for it. The Foundation said that its duty to pay never became due because the Special Company failed to complete the work on time, as required by an express condition in the contract. The Special Company asked the court for help.

QUESTION OF LAW Has the Foundation's duty to pay for the equipment become due?

DECISION Yes. The Foundation's duty to pay for the equipment has become due, because the Foundation wrongfully prevented the Special Company from performing and fulfilling the express condition precedent to the Foundation's duty to pay, and this wrongful prevention excused the condition.

Where a party wrongly prevents or hinders a performance which is also a condition, that wrongful conduct excuses the condition, and the duty that depends on that condition becomes due. In this case, the Special Company's delivery of the special de-mining equipment within four months of the contract date was an express condition precedent to the Foundation's duty to pay. However, the Foundation failed to supply clear plans or raw materials that the Special Company needed in order to construct the equipment by the four month deadline. As a result, the Company was unable to meet that deadline, despite diligent efforts to do so. In this situation, the Foundation's actions were a wrongful prevention of the Special Company's performance. This is because these actions actually prevented the Company from performing according to the contract. And it is very unlikely that the Company assumed the risk that the Foundation would act in this way. As a result, the express condition that the Company complete the work within four months will be excused, and the Foundation's duty to pay is due.

This situation could also be analyzed as the failure of an implied-in-fact condition precedent to the Company's duty to perform. The implied-in-fact condition would be the Foundation's supplying of clear plans and materials within a reasonable time. Under this analysis, the express condition to complete the work within four months would be excused by the failure of this prior condition. The failure or occurrence of prior conditions as an excuse was discussed in Section 9.4f, above.

There are several possible explanations for the rule that wrongful prevention or hindrance will excuse a condition, and cause the duty that depends on the condition to become due for performance. One idea is that a party's act of preventing or hindering the other party's performance is actually an implied condition subsequent, which would terminate the other party's duty to perform if it occurred. Or a party's act of not preventing or hindering the other party's performance might be considered an implied condition precedent to that other party's duty to provide the performance. So where there is a wrongful prevention or hindrance, it might actually be like the condition is excused because of the failure or occurrence of a prior condition, as discussed in Case Study 207 and Section 9.4f. In fact, this situation might be similar to many implied-in-fact conditions, which may exist where one party must cooperate in some way (such as by supplying plans or raw materials) if the other party is to perform.

Another possible explanation is that all contracts contain implied promises to cooperate, and not prevent or hinder the other party's performance. Under this idea, if a party does hinder or prevent another party's performance, that is a material breach. Such a material breach would also excuse any condition which consisted of the performance that was prevented or hindered. In a way, a breach like this would be similar to an anticipatory repudiation that was treated as a breach. This is because, in both situations, a party has breached before his main duty to perform was even supposed to be due! If the wrongful prevention was also a breach,

the party harmed (such as the Special Company in Case Study 207) would be entitled to stop his own performance, and to ask a court for a remedy for any damage caused by that breach. Anticipatory repudiation was discussed in Section 9.4d, above.

A wrongful prevention or hindrance might also be a material breach of the implied duty of good faith and fair dealing, although bad faith does not seem to be required for a wrongful prevention or hindrance to exist. The results of such a breach would be similar to the results of a breach of an implied promise to cooperate, as discussed above. The duty of good faith and fair dealing will be further discussed in Section 9.5c, below.

Finally, some courts say that a wrongful prevention or hindrance really creates a kind of estoppel. Estoppel is different from promissory estoppel. In general, estoppel occurs where a court says one party cannot make a particular legal claim or argument because he has acted in a way that is somehow inconsistent with that claim or argument. In the area of conditions, estoppel basically occurs where a party who has acted wrongly is prevented by his own acts from claiming in court that a condition was required to be fulfilled. Estoppel as an excuse of conditions will be discussed in Section 9.4i.

An important effect of a wrongful prevention or hindrance of the occurrence of a condition is to excuse that condition, and to cause the duty that depends on that condition to become due for performance. Another potential effect of wrongful prevention or hindrance would be a material breach of the contract, since the party who acts wrongfully could be viewed as violating implied promises not to do so, as discussed above. If a wrongful prevention or hindrance by one party was a material breach, it could discharge the duties of the other party, and also give the other party the right to ask a court for remedies for the breach. The effects of material breach, including the discharge of the duties of the non-breaching party, are further discussed in Section 9.4c, above, and Section 9.6b, below. A wrongful prevention or hindrance might also mean that a duty would not become due for performance at the time specified in the contract, and so a party's failure to perform that duty might not breach the contract. For example, this would probably be the case in Case Study 207, where the Special Company's late delivery of the de-mining equipment would probably not breach the contract.

9.4i Waiver or Estoppel of the Party Whose Duty Depends on a Condition May Excuse the Condition

Sometimes a party whose contract duty depends on a condition indicates through words or conduct that he will not insist that that condition be fulfilled in order for his duty to become due. This may result in a waiver, which will excuse the condition, and the waiving party's duty will become due even though the condition has not occurred.

A similar situation exists where estoppel applies. Estoppel basically occurs where the law says that it would be unfair to allow a party to make a certain legal claim or argument--such as that a condition must occur--because of inconsistent prior actions by that party. Estoppel may also excuse conditions, and cause the estopped party's duty to perform to become due.

The following Sections explain how waiver and estoppel can excuse conditions.

(1) Introduction to Waiver of Conditions

As noted above, if a party waives the right to insist on a condition, that condition is excused, and the duty that depends on the condition will become due.

*** **DEFINITION:** A **waiver** is often defined as the intentional relinquishing or giving up of a legal right that is known by the holder of that right.

Although the above definition is a common one, it appears that a waiver may occur even if it is not so clear that a party actually "knew" he had the benefit of a condition, or that he "intended" to give it up. It seems that courts can imply that a party "knew" about his right to the benefit of a condition, and that he "intended" to give up that right, because of the actions of that party. In reality, what seems to matter is that the party knew the factual situation relating to his contract--not that he actually knew his exact legal rights. For example, if an employer in a service contract knowingly accepts some performance that is less than what the contract requires, this can be a waiver even if it is not clear that the employer actually knew he had the benefit of a condition, or actually intended to give it up. This will be explained in more detail below.

There are basically two important situations where a party may waive his right to argue that his contract duty is not due because a condition has not occurred. These situations are where a party waives this right: (1) before the condition is scheduled to occur; and (2) after the condition fails to occur. The rules about these two situations are explained in some detail in the Sections below. However, the paragraphs immediately below try to summarize the basic, general rules.

Before a condition is scheduled to occur, it appears that a party whose duty depends on the condition generally can waive the right to the benefit of that condition, except that most material, express conditions cannot be waived in common law jurisdictions. The reason for this exception appears to be that such waivers are likely to change the basic nature of the parties' agreement but leave the waiving party without an adequate legal remedy, as will be explained below. But there also appear to be limits on this exception,

and it may not apply where promissory estoppel exists, or where special statutes such as those governing the sale of goods apply.

After a condition fails to occur, a party whose duty depends on the condition may elect to continue with the contract despite the failure of the condition. If a party does this--either by saying so expressly, or impliedly by continuing his own performance or by accepting benefits under the contract--then that party will have waived his right to argue that a contract duty has not become due because the condition failed. This kind of waiver appears to be possible as to all kinds of conditions, whether they are material or not.

However, even if a party does waive his right in these ways, that party still generally has the right to ask a court for a remedy to compensate him for any breach that may result from the other party's failure to perform a promise. Such waivers affect only conditions--not promises, nor the breaches that occur when such promises are broken.

One other important point about waivers of conditions is that they are generally not subject to several requirements that modifications of contracts normally are. Specifically, such waivers are generally not subject to writing requirements, requirements of real agreement between the parties, or consideration requirements in common law jurisdictions. Of course, such waivers must meet certain other requirements to be effective, as will be discussed below.

With regard to consideration, as discussed in Chapter 3 ("Consideration"), Section 3.7, common law jurisdictions generally require new consideration for modifications of contracts, since such modifications are really new contracts. This means that parties cannot generally waive the right to a performance under a contract--the right to receive the benefit of a promise--unless there is some new consideration. But conditions are different from promises. As noted above, a waiver of a condition does not mean the party is waiving the right to the benefit of a promise. Waiving a promise would generally change the basic nature of an agreement, and require new consideration. But waiving a condition generally will not cause such a change in the basic nature of an agreement, except in particular situations that will be explained below. So conditions are treated differently from promises, and they can generally be waived without new consideration.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7 discussed the general rule that common law jurisdictions require consideration for modifications of contracts.

*** ***WHY IS THIS IMPORTANT?*** Why does the law say that parties may waive the right to insist on conditions?

There are several possible reasons the law says that conditions may be excused by waiver. One potential reason is to try to be fair to both parties

to a contract. Where waiver applies, the waiving party has given the other party reason to believe that the waiving party will not insist on the occurrence of a condition. In particular, where there is a waiver, parties will often detrimentally rely on the waiver. Where there is such reliance, it would be unfair to say that the condition had to be fulfilled in order for the other party's duty of performance to become due.

Of course, the law also recognizes the importance of conditions and wants to protect them. That is why common law jurisdictions say that most material express conditions cannot be waived, in the absence of justifiable reliance or some other exception. Such waivers might change the basic nature of the parties' agreement but leave the waiving party without an adequate legal remedy. The law also provides that waivers before conditions are scheduled to occur can be revoked, unless there is justifiable reliance. These rules give some protection to the parties who waive, and try to ensure that the rules about waivers are not applied so broadly that they actually weaken contracts.

Another potential reason for the rules allowing waiver of conditions is economic flexibility and efficiency. The law wants to give some flexibility to parties to adjust their behavior to accord with the realities of the modern world. As noted above, waivers are not generally subject to several of the important requirements that contract modifications usually are (such as the requirement of consideration in common law jurisdictions). These rules allow parties to perform their contracts and react to changing circumstances without having to worry too much about the technical rules of conditions. They also allow more contracts to be performed--and more economic activity to occur--by allowing parties to choose not to insist that the rules on conditions apply strictly in certain cases. This is especially true of the rules about waiver and modifications in commercial contracts, such as sale of goods contracts. For example, as explained below, some commercial laws in common law jurisdictions require no consideration for modifications of sale of goods contracts.

(2) Waiver Before a Condition Is Scheduled to Occur May Excuse That Condition

Sometimes a party whose duty depends on a condition indicates--before that condition is scheduled to occur--that he will not insist on the fulfillment of the condition. In this situation, it appears that a party generally can waive the right to the benefit of the condition. This waiver will excuse the condition, and the duty that depends on the condition will become due even though the condition has not occurred. But such waivers affect only conditions--not promises. So they do not affect the breaches that occur when promises are not followed.

For example, where a builder agrees to build a house on certain property of a land owner, the land owner could probably waive a condition

that required the construction to be completed by a certain date. If the owner did waive such a condition, then the condition would be excused, and the owner's duty to pay would become due even though the condition had not occurred. Of course, as will be explained below, the owner would still have a right to bring a lawsuit for any damage caused by the failure of the builder to follow the contract--by the builder's breach.

However, there appears to be an important exception to the general rule that conditions can be waived before those conditions are scheduled to occur. This exception is that in many common law jurisdictions, most material express conditions cannot be waived. Material conditions are basically those that are important to the bargain between the parties, and whose loss would cause an important change to the contract. Common law jurisdictions generally require consideration for changes like that.

For instance, in a property insurance contract, the insurance company could not waive the condition that there must be some damage to the property in order for its duty to pay for that damage to become due, because that would clearly change the fundamental idea of the contract. It would also appear to cause the insurer's duty to pay to become due for no reason, and the insurer might have no adequate legal remedy, since there would be no breach by the other party for which the insurer could get a legal remedy.

On the other hand, there appear to be two limits on this exception. Where these limits apply, it may be possible to waive even material express conditions. Specifically, a party may be able to waive his right to the benefit of even such conditions where:

(1) promissory estoppel applies;

or (2) certain statutes allow it, such as statutes governing the sale of goods.

This exception and the limits on the exception are discussed below.

(1) Most material, express conditions cannot be waived in many common law jurisdictions. Many common law jurisdictions say that, before a material express condition is due to occur, the party whose duty depends on that condition may not waive the right to the condition.

Authorities do not appear to be consistent or clear about the scope of this exception. Some authorities seem to say that no fundamental conditions can be waived, while others appear to say that no material conditions can be waived--not only material express conditions. However, such broader exceptions might make less sense. The reason material, express conditions cannot be waived is to protect parties like the insurance company in the example above from having to perform duties without receiving anything in return, and without any legal remedy, since there may be no breach in such situations. Obviously the insurance company could not waive the express

condition of there being some damage to the property in order for its duty to pay for that damage to become due--how could the insurance company's duty to pay for damage become due if there was no damage?

However, in the case of implied-in-law conditions, even if a party waives the right to insist on a material condition, the party still has the right to ask a court for a remedy if the other party fails to perform. This is because implied-in-law conditions tend to actually be performances that the parties have promised in the contract.

For example, suppose a land owner who is having a house built on his land waives his right to have substantial performance occur--the implied-in-law condition precedent--before his duty to pay becomes due. It is true that the land owner would waive the right to withhold payment until this substantial performance occurs. But the builder would still be obligated by his contract promise to build the house according to the contract. If the builder failed to build the house according to the contract, the land owner could still ask a court for a remedy for that breach. All the land owner would waive would be the right to withhold payment--the right to have the other party perform first. This might be a useful right, as explained in Section 9.3 above. But to waive it would not necessarily cause a material change in the nature of the contract--because it would appear that all that would change in many cases would be the sequence of performance!

Another example might be where the buyer in a sale of goods contract says to the seller: "I will not require that you deliver the goods when I pay--I waive the condition of getting your performance at that time." This would be a waiver of the implied-in-law condition concurrent to the buyer's duty to pay. But again, in that situation, the buyer does not waive the right to damages for a breach. So if the seller fails to perform--by failing to deliver the goods--the buyer can still bring a lawsuit for the breach. In any event, it is important to check the local law in the relevant jurisdiction about this area of the law.

(a) Conditions may be waived if all the requirements of promissory estoppel are met. In common law jurisdictions, before a condition is due to occur, the party whose duty depends on that condition may waive the right to the condition if the requirements of promissory estoppel are met. This would appear to limit the exception that material express conditions cannot be waived. The reason is that no consideration is required where a promise is enforceable because of promissory estoppel--even if the condition waived is a material one. This text has already discussed promissory estoppel (detrimental reliance) in detail, particularly in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

As discussed in detail in Chapter 7, promissory estoppel applies where one party justifiably relies on a promise by another party, and a court decides that it is necessary to enforce the promise in order to avoid injustice--

even though the promise would not otherwise be enforceable because of a lack of consideration or some other problem.

For example, suppose a law professor agreed to write a law book for a publisher, and the contract stated that the law professor would be paid 10,000 riels per page provided that the professor drank no alcohol during the period in which he wrote the book. If the professor did drink alcohol, then the payment would be only 3,000 riels per page. Suppose the professor starts writing, and then the publisher assures him that he need not comply with the alcohol provision, and the professor reasonably relies on that promise in finishing the book. In that case, a court might find that justice required enforcing the publisher's promise that the publisher would not require that the professor follow the express condition. In other words, a court might find that the publisher could not argue that the professor failed to fulfill the alcohol condition, and that the publisher's duty to pay 10,000 riels per page became due. And this would be true even though the alcohol provision might be a material express condition in this contract, since it would affect the contract price and perhaps other aspects of the performance so greatly.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.8 discussed promissory estoppel in detail.

(b) Certain statutes, such as some statutes governing the sale of goods, may have the effect of allowing waivers even as to material express conditions. Sometimes particular statutes in common law jurisdictions may have the effect of allowing waivers even as to material parts of contracts. This is because those statutes may say that consideration is not required as to certain types of agreements.

For example, under the Uniform Commercial Code in the United States, no consideration is required for agreements to modify sale of goods contracts, as long as such modifications are made in good faith. The effect of this exception to the consideration requirement would appear to be that parties can also waive conditions in sale of goods contracts--even if they are material express conditions. For example, it would appear that this exception would allow a party to waive an express condition that he must receive goods of a certain quality before his duty to pay becomes due, even though that kind of change might create a material change in the bargain.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7a discussed the exceptions to the general rule that common law jurisdictions require consideration for modifications of contracts, including the exception for sale of goods contracts in some jurisdictions.

One important element of waivers of conditions before the conditions are scheduled to occur is that the waivers can generally be revoked until the time that the other party justifiably relies on the waiver. This basically means that a party who waives the right to insist on the occurrence of a condition

may change his mind, and insist on that occurrence, until the other party justifiably relies on the waiver. If that occurs, the waiver cannot be revoked anymore, because under the doctrine of promissory estoppel a promise (including a waiver) is enforceable to the extent necessary to avoid injustice if a party justifiably relies on that promise.

For instance, in the example above about the law professor and the "no alcohol" condition, the publisher could have revoked its waiver of the condition up until the time the law professor justifiably relied on it. But after the time such reliance occurred--which might have been the time when the law professor started to drink alcohol as he wrote--the publisher's waiver could no longer be revoked.

As noted above, the effect of a waiver of the right to insist that a condition occur is that the condition is excused, and the duty that depended on that condition will become due even though the condition has not occurred. However, even if a party does waive this right, he still generally has the right to ask a court for a remedy such as money damages to compensate him for any breach that may result from the failure of the other party to perform a contract duty, unless the failure is permitted by a binding modification of the contract.

For instance, in the house building example above, the land owner might waive the right to insist on a condition such as that the house be completed by a certain date. But since the builder's failure to complete the house by that date would still be a breach of the contract--because it would be a breach of the builder's contract promise--the land owner could still ask a court for a remedy to compensate him for the breach.

*** ***CASE STUDY 208***

FACTS Ngneth is a bean farmer. She makes a contract to sell 10 tons of beans to the Big Bear Beans Corporation at a certain price per ton, with delivery to occur one month from the date the contract is signed.

One week before delivery is to occur, Ngneth contacts the Beans Corporation and says that she will be able to deliver only 8 tons, because she has had a poor harvest. The Beans Corporation sends Ngneth a note that says: "That's all right. We cannot agree to change the amount of beans due under the contract, but we'll take 8 tons."

However, when Ngneth delivers 8 tons of beans to the Beans Corporation, the Corporation refuses to accept the beans! The Corporation says that it has no duty to pay for any beans, because Ngneth has failed to fulfill the implied-in-law condition concurrent to its duty to pay, by failing to deliver the 10 tons required by the contract. Ngneth asks the court for help.

QUESTION OF LAW Has the Beans Corporation's duty to pay for the beans become due?

DECISION Probably. The Beans Corporation's duty to pay for the beans has probably become due, because the implied-in-law condition that was the delivery of 10 tons of beans was excused by the Beans Corporation's waiver of its right to insist that the full 10 tons be delivered in order for its duty to pay to become due. And the Corporation's improper rejection of Ngneth's tender of 8 tons of beans caused the Corporation's duty to pay to become due. The Corporation must pay for the beans as required by the contract--but it can also ask a court for a remedy for any damage caused by Ngneth's failure to deliver the full 10 tons as she promised in the contract.

Where a party waives his right to insist on the occurrence of a condition before that condition is scheduled to occur, that waiver excuses the condition, and the duty that depends on that condition becomes due. In this case, the Beans Corporation told Ngneth that it would not insist on the full 10 tons of beans required by their contract, when it said that it would accept the 8 tons that Ngneth would be able to deliver. This was a waiver of the Beans Corporation's right to insist that the full 10 tons of beans be delivered before its duty to pay became due--a waiver of the implied-in-law condition concurrent to the Corporation's duty to pay for the beans. And since this was an implied-in-law condition--and a sale of goods contract--it does not appear to matter whether the condition is considered to be a material part of the contract or not. Therefore, the condition that 10 tons of beans be delivered was excused, and Ngneth was required to deliver only 8 tons of beans in order for the Corporation's duty to pay to become due.

However, when Ngneth tendered 8 tons of beans, the Corporation rejected her tender. This rejection was improper, because the Corporation had waived its right to insist that the full 10 tons be delivered in order for its duty to pay to become due. The Corporation was required to accept 8 tons of beans--but it did not. This improper rejection excused the condition that was Ngneth's delivery of the beans, and the Corporation's duty to pay became due. If the Corporation does not pay for the beans, Ngneth may ask a court for a remedy for any damage caused by the Corporation's failure to perform its duty to pay.

On the other hand, it is important to remember that the Corporation will also have the right to ask the court for a remedy for Ngneth's breach of the contract! Ngneth breached the contract because she failed to deliver the 10 tons as she promised in the contract, and she will be liable for any damage this breach caused to the Corporation. The Corporation waived its right to insist on the occurrence of the condition on which its duty to pay depended. But it did not agree to modify the amount of beans due under the contract, and it did not waive the right to receive a remedy for Ngneth's breach of the contract. So while the Corporation must pay for the beans, Ngneth must pay for any damage caused to the Corporation by Ngneth's failure to deliver the full amount she promised to deliver. Obviously, this damage will include damage suffered by the Corporation because it did not receive two tons of beans required by the contract.

(3) Waiver After a Condition Fails May Excuse That Condition

Waivers may also occur after a condition has actually failed to occur. In particular, after a condition fails to occur, a party whose duty depends on the condition may elect to continue with the contract despite the failure of the condition. A party may show that he has chosen to continue with a contract despite the failure of a condition in several ways. Specifically, a party may show that he has chosen to do this expressly. He may also do so impliedly, by continuing his own performance or accepting benefits under the contract. In those situations, the party waives his right to argue that his contract duty has not become due because the condition failed. It appears that this kind of waiver could occur even as to material express conditions in common law jurisdictions. In addition, courts say that this kind of waiver generally cannot be revoked.

However, as noted above, even if a party does waive his right to the benefit of such conditions, that party still generally has the right to ask a court for a remedy to compensate him for any breach that may result from a failure to perform duties under the contract, unless the waiver is also a binding modification of the contract. Binding modifications of contracts are generally subject to all the usual formation requirements, including offer and acceptance, consideration, and formality requirements.

When a condition fails to occur because a party has failed to fulfill it, and the condition has not been excused, the party whose duty depends on that condition really has a choice, or an "election" to make. Specifically, that party may choose to:

(1) stop his performance and ask a court for a remedy for any damage caused by the other party's breach;

OR (2) continue under the contract.

A party cannot do both of these things at the same time. Therefore, that party must choose or "elect" one option. If he elects to continue with the contract, he has waived the right to the benefit of the condition that failed, although he will still have the right to recover any damages caused by the other party's breach.

For example, suppose a contract for the sale of a radio contains an express condition that the radio will be delivered in "perfect working order," or else the buyer will have no duty to pay. If the radio is delivered in less than "perfect working order," perhaps because it cannot receive certain radio stations well, then the buyer has an election to make. The buyer may choose to reject the radio and sue for breach of the contract promise that the radio would be in "perfect working order." Or the buyer may choose to continue under the contract, which could occur if the buyer accepts the radio. In that case, the buyer has waived his right to insist on the condition that the radio be delivered in perfect working order in order for the buyer's duty to pay to become due. So the buyer must pay for the radio even though it does not

work perfectly. Of course, even if the buyer chooses to accept the radio, he still generally has the right to a remedy for any damage caused to him by the seller's breach of the promise that the radio work perfectly, unless his waiver is also a binding modification of the contract.

If a party does choose to continue with a contract--and waive the right to insist on the benefit of a condition--that party may waive the condition expressly or impliedly. An express waiver occurs where a party basically says in words that he will not insist on the benefit of a condition. For instance, in the radio example above, suppose the buyer receiving the defective radio simply said: "That's OK--I will not insist on the condition that the radio be perfect in order for me to pay." Those words would be an express waiver, and the buyer's duty to pay for the radio would become due--though the buyer would still be entitled to compensation for any damage caused by the seller's breach, unless there was a binding modification of the contract.

An implied waiver of a condition will generally occur where the party who has the benefit of the condition:

(1) continues his own performance under the contract after learning that the condition has failed;

OR (2) accepts benefits under the contract after learning that the condition has failed.

For instance, in the radio example, the buyer might be considered to have continued his performance under the contract if he paid the seller the purchase price, even though he saw that the radio did not work perfectly. Another example might be where a service contract contained a condition that the employer pay a contractor in advance for some work. If the employer's payment was clearly defective, but the contractor elected to perform the work anyway, then the contractor would have continued performance under the contract, and waived the condition precedent to his duty to do the work. Examples of accepting benefits under a contract might be if the radio buyer accepted the radio, or if the contractor accepted some portion of the payment he was due. In these cases, the party would have waived his right to insist that the condition occur, and his duty to perform would have become due.

One very important aspect of waivers of conditions after those conditions fail to occur is that such waivers are generally irrevocable. That means that, once a party elects to waive his right to insist on the occurrence of such a condition, that party generally cannot change his mind and try to insist on the condition. For example, once the contractor in the above example decided to accept benefits or continue his own performance under the contract, he could no longer choose to insist on the condition he waived. Potential reasons for this rule include that courts feel that parties should be able to rely on such elections, and that courts wish to promote finality in the performance of contracts. However, laws in some jurisdictions may allow the revocation of such waivers in certain circumstances. For example, it appears that

the Uniform Commercial Code in the United States allows a buyer to "revoke" his acceptance of goods under certain circumstances. This will be further discussed in Section 9.5b, below.

One problem that may occur where a party elects not to continue with a contract because of the failure of a condition is what the party says--or does not say--about why he is rejecting the performance of the other party. The general rule appears to be that a party is not required to say why he is rejecting a performance in order to preserve his right to insist on the benefit of the condition. In other words, as long as the condition is not fulfilled, the other party may simply refuse to continue with the contract, without giving any reason.

However, sometimes a party does state a reason why he is not continuing with the contract--but that reason is not what caused the condition to fail! For example, this might happen if the buyer in the radio sale contract rejected the radio because it was the wrong color--not because it failed to work perfectly. Even in that situation, it appears that the party generally has not waived the condition unless:

(1) the other party would have been able to fix or "cure" the problem if he knew about it;

and (2) the rejecting party knew or should have known that.

Again, this rule applies only if a party chooses to say why he is rejecting performance under the contract. It appears that the rejecting party is generally not required to say why he is rejecting.

However, these rules about stating the reason for failure to fulfill conditions may be somewhat different under certain statutes governing the sale of goods, or other specific types of contracts. For example, the Uniform Commercial Code in the United States says that if a buyer rejects goods but fails to specify a particular defect of the goods, then the buyer cannot rely on that particular defect to justify his failure to continue with the contract if:

(1) the seller could have fixed the defect if he knew about it within a reasonable time;

OR (2) the buyer and seller are both merchants, and the seller makes a written request for a full statement of all defects, but the buyer fails to include the particular problem on any such list.

This kind of rule--which does not allow the buyer to say nothing about why he is rejecting in the two situations above--puts more pressure on buyers of goods to state the correct reason they are rejecting goods. Section 9.5b below discusses when buyers have the right to reject goods under the Uniform Commercial Code. In any case, it is important to check the law related to the contract in question.

Another way to think about the kind of waiver discussed in this Section is as the waiver of a right to a completely perfect tender. However, as explained above, there are limits on a party's ability to make such a waiver. Improper rejection of a tender as an excuse for conditions was discussed in Section 9.4g, above.

One effect of a waiver of the right to insist on the fulfillment of a condition after the condition has failed is that the condition will be excused. And the waiving party's duty will become due even though the condition has not occurred.

However, as discussed above, the waiver of a condition does not mean that the waiving party loses the right to ask a court for a remedy for any damage caused by a breach of the contract, unless the waiver is also a binding modification of the contract. In other words, if a condition consists of a performance by a party under the contract, and the other party waives the right to insist that that condition occur in order for the duty that depends on it to become due, the waiving party still generally has the right to a remedy for any damage caused by the other party's failure to fulfill the condition--damage from the other party's breach.

Laws in some jurisdictions do provide that where the waiving party accepts a performance, that party must notify the other party about the breach within a reasonable time if he wishes to seek a remedy for any breach in that performance. For example, the Uniform Commercial Code in the United States says that a buyer who accepts goods must provide such notice within a reasonable time after he discovers or should have discovered such a breach.

******* ***CASE STUDY 209***

FACTS The Double Happiness Import-Export Company makes a property insurance contract with Kamco Insurance Company. Under the contract, Kamco agrees to insure Double Happiness' new warehouse for damage that might be caused in a number of ways, for three years, for a certain premium. Part of the contract says that Kamco "will have no duty to pay for any loss claimed under this insurance policy unless the policyholder provides notice of that loss to Kamco within one month of the loss." Another part of the contract states that the contract can be modified only in writing.

One year later, Double Happiness' warehouse is heavily damaged by a fire, which is a type of loss covered by the insurance policy. However, because of all the confusion surrounding the fire, Double Happiness fails to give notice to Kamco about the loss until two months after the fire.

At first, Kamco says nothing about the notice clause in the contract. Instead, Kamco spends a lot of time gathering information about Double Happiness' claim, and negotiating with Double Happiness about the amount of a possible settlement of the claim. Unfortunately, the parties are unable

to reach an agreement about the amount of loss Double Happiness has suffered. Suddenly, Kamco claims that the loss is not covered at all because Double Happiness failed to give timely notice, and this was an express condition to any payment by Kamco! Double Happiness asks the court for help.

QUESTION OF LAW Has Kamco's duty to pay for the loss to the warehouse failed to become due because of Double Happiness' failure to give timely notice?

DECISION No. Although Kamco's duty to pay for any claim was expressly conditioned on Double Happiness providing timely notice of loss, Kamco waived the right to insist on that condition by continuing to perform under the contract, so its duty to pay for the loss will become due (assuming the loss is covered otherwise).

Where a party waives his right to insist on the occurrence of a condition after that condition has failed to occur, that waiver excuses the condition, and the duty that depends on that condition becomes due. Such a waiver can occur expressly, or impliedly if the waiving party accepts benefits under the policy or continues its own performance under the policy.

In this case, the property insurance policy Kamco issued to Double Happiness contained an express condition: Kamco would have no duty to pay for any loss unless Double Happiness provided notice of that loss within one month. And in this case, Double Happiness failed to give that notice on time. However, Kamco at first said nothing about the notice. In fact, Kamco fully investigated Double Happiness' claim, and conducted negotiations to try to reach an agreement with Double Happiness about the amount of loss. It was only after the parties could not agree about this amount that Kamco said the claim was not covered because of the lack of timely notice. Under these circumstances, Kamco has waived its right to insist that the express condition of timely notice occur. This is because Kamco has clearly continued its own performance under the policy, by investigating and negotiating about the claim. Therefore, the condition has been waived. The waiver cannot be revoked, and Kamco's duty to pay will become due despite the failure of the condition to occur (assuming the claim is covered by the policy in other respects).

This waiver was not an enforceable modification of the contract, since it was not written as the contract itself requires, and perhaps for other reasons. So Kamco will be entitled to a remedy for any damage it has suffered because of Double Happiness' breach: the failure to give timely notice as it promised in the contract.

The illustration below compares some basic aspects of waivers before a condition is scheduled to occur and waivers after a condition has failed.

Illustration: Waiver Before Condition Is Scheduled to Occur and Waiver After Condition Fails to Occur

	Waiver Before Condition Scheduled to Occur	Waiver After Condition Fails to Occur
1. What is it?	A party gives up his right to insist that a condition occur in order for his duty to become due	A party gives up his right to insist that a condition occur in order for his duty to become due
2. Can it apply to any condition?	No--material express conditions cannot generally be waived in many common law jurisdictions, unless an exception like promissory estoppel applies	Apparently yes
3. What is the legal effect?	The condition is excused	The condition is excused
4. May party still ask for remedy for breach?	Yes, unless the waiver is part of a binding modification of the contract	Yes, unless the waiver is part of a binding modification of the contract
5. Is retraction or revocation of waiver possible?	Generally yes, until the other party justifiably relies on the waiver	Generally no
6. What are the main differences?	(a) Does not generally apply to material express conditions in many common law jurisdictions	(a) Apparently no limit on conditions that may be waived after failure
	(b) Generally revocable	(b) Generally not revocable

(4) Estoppel May Excuse a Condition

A similar doctrine that--like waiver--says the actions of a party can result in that party no longer being able to insist on a condition is the doctrine of estoppel. Estoppel can occur because of the conduct of a party, rather than just because of a promise.

*** **DEFINITION: Estoppel** generally occurs where a court says a party cannot make a particular legal claim or argument because of some action of that party that is inconsistent with the claim or argument.

Estoppel is somewhat similar to waiver. Both doctrines basically say that, because of some action (either words or conduct) by a party, that party cannot insist that a condition occur in order for his duty to become due for performance. Estoppel is particularly similar to implied waivers made after

a condition fails to occur, since both events involve some action by a party that means the party cannot insist on the occurrence of a condition.

Estoppel is also similar to promissory estoppel (detrimental reliance), but it is not the same. Like promissory estoppel, estoppel involves some activity by a party that results in that party losing some legal right, whether it is the right to not perform a promise (as with promissory estoppel), or the right to make a particular legal claim or argument (as with estoppel). But estoppel does not require a promise, and it does not require justifiable reliance. Instead, it occurs in particular situations where the law says it would be unfair to allow a party to make a particular legal claim or argument, because of some conduct of that party that is inconsistent with that claim or argument. If estoppel exists, a party may be unable to insist on the occurrence of a condition.

One important situation where estoppel may occur is where there is wrongful prevention or hindrance. One way to analyze that situation is to say that the party who acted wrongly is estopped by his own acts from claiming in court that the condition was not fulfilled. The reason is that the party's actions--in actually preventing or hindering the occurrence of the condition--are inconsistent with such a claim.

For example, in Case Study 207, a court might say that the De-mining Foundation was estopped from claiming that the Special Equipment Company had failed to fulfill the express condition that it deliver the equipment within four months. A court might say this because the conduct of the Foundation in preventing the condition from being fulfilled was inconsistent with such a claim. Therefore, the express condition that was the Special Company's delivery of the equipment within that time would be excused. So the Foundation's duty to pay for the equipment would become due even though that condition was not fulfilled.

9.4j Impossibility of Performance May Excuse a Condition

Sometimes a condition cannot be fulfilled because it actually becomes impossible for it to be fulfilled, through no fault of either of the parties. For example, a condition may become impossible to fulfill because the government passes a law making that type of activity illegal. When impossibility occurs, the condition will be excused if:

(1) the condition does not involve a material part of the contract; and

(2) a forfeiture could result from the failure to fulfill the condition.

If the condition is excused, then the duty that depends on that condition will become due even though the condition was not fulfilled.

To understand the exact situations where impossibility occurs can be difficult, and those situations will not be discussed in detail here.

Impossibility is discussed in Section 9.8a, which explains how it may discharge contract duties.

The practical result of this rule varies depending on what type of condition has become impossible. It appears that implied-in-law conditions generally cannot be excused by impossibility, since such conditions generally consist of performances that are material parts of contracts, and forfeiture is less likely to result because of their failure. But it appears that express conditions and implied-in-fact conditions generally will be excused by impossibility, provided that they do not involve material parts of the contract and there is a risk of forfeiture. The effects of this rule on the different types of conditions are briefly discussed below.

(1) Implied-in-law conditions generally are not excused by impossibility. Implied-in-law conditions generally involve material parts of contracts, and their failure is less likely to result in forfeiture. So courts say that they generally cannot be excused because of impossibility. For example, the conditions concurrent that courts often imply in sale of goods or sale of land contracts, and the conditions precedent that courts generally imply in service contracts, all involve performances that are material parts of the contract. This is because they involve performances that are basically the whole performances of the parties to the contract. In addition, in those situations, the risk of forfeiture is usually not present, because forfeiture basically means losing something significant with no adequate legal remedy. If these kinds of conditions fail, it is usually because the parties have simply failed to provide the performance on which the duties depend. Where parties have simply failed to provide their performances under these contracts, courts do not seem to feel that those parties have lost something significant, since they generally have not provided their performances. So even if it becomes impossible to fulfill this kind of condition--such as the condition that a shipment of goods be delivered--that condition will not be excused, and the duty that depends on it will not become due.

However, even though an implied-in-law condition will probably not be excused because of impossibility, the party who would normally be required to fulfill that condition under the contract will not be required to do so by a court. This is because the impossibility will discharge the duty of that party to provide the impossible performance. And the party who cannot perform will not be required to provide a remedy to the other party because of his failure to perform. So the party whose performance is the condition will not be liable for his non-performance, and the other party's duty will never become due, since the condition precedent or concurrent to it will not be fulfilled or excused. In other words, neither party will be required to perform his duty under the contract. If courts did not have such a rule, then forfeiture could occur more often as a result of the failure of implied-in-law conditions. And of course, if the party whose performance becomes impossible has already given some benefit to the other party when the rest of his performance becomes impossible, the performing party may be able to recover restitution.

The ways impossibility can discharge duties are discussed further in Section 9.8a, below.

(2) Express conditions and implied-in-fact conditions may be excused by impossibility if they do not involve material parts of the contract and there is a risk of forfeiture. Express conditions and implied-in-fact conditions exist because of the particular intentions or situations of the parties to each contract, rather than the legal rules courts make to apply to broad classes of contracts. So express or implied-in-fact conditions may be less likely to involve material parts of contracts. In fact, such conditions will be excused because of impossibility, and the duties that depend on them will become due, where two requirements are met:

(a) the condition does not involve a material part of the contract;

AND (b) there is a risk of forfeiture because of the failure of the condition.

For example, suppose there was an express condition in a service contract that said the employer would have no duty to pay the contractor for his work unless the contractor came to see the employer on the day the work was finished, in order to tell him the good news. If the contractor finished the work, but the express condition was impossible to fulfill--perhaps because the contractor was detained by the police for the rest of that day--then the condition would likely be excused. The reason is that the condition probably did not involve a material part of the contract, and its failure would result in a forfeiture in this case. It was not material because it did not involve the main performances of the parties under the contract (work for money). And the risk of forfeiture was great because if the condition failed, the contractor would have no way to recover the money due to him under the contract itself--since the employer's duty to pay would not become due. The law wants to avoid that situation. Another example appears in the following Case Study.

*** ***CASE STUDY 210***

FACTS Socheatra makes a contract with the Big White Villa Construction Company. Under the contract, Big White agrees to build Socheatra a new house on some land she owns, for a certain price. One part of the contract says that Socheatra will be required to pay the contract price "only on condition that the architect Seng Meng first issue an architect's certificate of adequate construction."

Big White builds the house according to the plans, but before the Company can obtain the certificate from Seng Meng, Seng Meng dies. Big White asks Socheatra to pay for the house without the certificate, since it is now impossible to get a certificate from Seng Meng. But Socheatra says she is not required to pay, since the express condition to her duty has not been fulfilled.

QUESTION OF LAW Has Socheatra's duty to pay for the construction of the house become due?

DECISION Yes. Socheatra's duty to pay for the construction has become due because the express condition to that duty--the obtaining of the architect's certificate from Seng Meng--will be excused because of impossibility.

Where the occurrence of a condition becomes impossible, the condition does not involve a material part of the contract, and there is a risk of forfeiture, the condition will be excused, and the duty that depends on that condition will become due even though the condition has not been fulfilled.

In this case, the construction contract between Big White and Socheatra contained an express condition precedent to Socheatra's duty to pay for the house: that Socheatra obtain an architect's certificate from Seng Meng. Big White finished the house as required by the contract, but unfortunately, Seng Meng died before he could issue the certificate. In this situation, the express condition will be excused, and Socheatra's duty to pay for the house will become due. The reason is that this express condition--the obtaining of the certificate--does not involve a material part of the contract. It does not involve the main exchange of performances under the contract (construction for money). In addition, there is a great risk of forfeiture: Big White built the house, but if the condition is not excused, Socheatra will have no contract duty to pay for it! So a court would excuse the condition. This will eliminate a risk of forfeiture by Big White, which might otherwise build an entire house and receive nothing in return.

9.4k Failure of a Condition to Occur May Not Affect the Whole Contract If the Contract Is Severable

In some contracts, the performances of the parties can be fairly divided into more than one corresponding part, because of the nature of those performances. Courts say that such contracts are "severable" or "divisible."

Where a contract is severable, the failure of a condition to occur with respect to one part of the contract does not affect the performance of the other part or parts. In other words, even if a party fails to fulfill a condition as to one part of such a contract, the party can still perform the rest of the contract, fulfill conditions as to the rest of the contract, and cause the duties of the other party to become due as to the rest of the contract. So the duty of the other party to provide his performance as to the rest of the contract may become due even if the first party has completely failed to perform one part of the contract! In these situations, the courts are really treating the different parts of the contract to some extent as if they were separate contracts. Of course, if the failure of a condition is also a material breach of the whole contract, the duties under the contract may be discharged, as discussed in Section 9.6b below.

However, many contracts are not severable. If a contract is not severable, courts say that it is "entire." The rules discussed in this Section do not apply to contracts that are entire.

For example, suppose a watch repairer makes a contract to repair a watch for a watch owner for 10,000 riels. Courts will generally find that the repair of the watch will be an implied-in-law condition precedent to the watch owner's duty to pay for the repairs, since the repairs will probably take some time, but the payment can occur in an instant. If the repairer fails to substantially perform the repairs, the watch owner's duty to pay will not become due. This is an example of an "entire" contract.

But if the watch repairer made a contract in which he agreed to repair two different watches for the watch owner--one for 10,000 riels and one for 7,000 riels--then a court might find a severable contract. The reason is that the performances of the parties can probably be fairly divided into more than one corresponding part. In this case, there might be two parts: (1) the repair of the first watch in exchange for 10,000 riels; and (2) the repair of the second watch in exchange for 7,000 riels. The effect of this contract being severable is that the watch repairer's failure to fulfill the condition precedent as to the first watch will not affect the performance of the contract as to the second watch. Suppose the repairer fails to substantially perform the repairs on the first watch, but does substantially perform the repairs on the second watch. In that situation, the watch owner's duty to pay 10,000 riels for the repair of the first watch will not become due, because the condition precedent to that duty has failed. But the watch owner's duty to pay 7,000 riels for the repair of the second watch will become due! This is because the watch repairer has fulfilled the condition precedent to that duty, by substantially performing the repairs on the second watch.

As noted above, only certain contracts are severable with regard to conditions. The general rule is that contracts are severable, for the purpose of analyzing conditions, if the performances of duties under the contract can be fairly divided into more than one corresponding part. More specifically, many jurisdictions say that such contracts are severable if three requirements are met:

(1) performance by each party can be divided into more than one part;

(2) the number of parts due from each party is the same;

AND (3) performance of each part by one party appears to be the agreed exchange for the performance of the corresponding part by the other party.

When courts apply this test to determine whether a contract is severable, they generally try to determine whether the parties appear to have intended that the contract be severable at the time they made the contract. One thing

that might help a court decide whether a contract was severable would be if the contract actually said that it was not severable. In that situation, it appears that a court would generally find the contract not to be severable.

The analysis of whether a contract is severable with regard to conditions may differ from the analysis with regard to other areas. Of course, the idea of severing parts of contracts was already explained in previous Chapters, including Chapter 5 ("Legality"), Section 5.5b, in the discussion of severing illegal parts of agreements, and also in Chapter 7 ("Other Contract Formation Problems"), Section 7.7c, in the discussion of severing unconscionable parts of agreements. Although the rules about severance that courts apply in these different situations may not be exactly the same, the basic idea is the same.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.5b discussed severing illegal parts of agreements, and Chapter 7 ("Other Contract Formation Problems"), Section 7.7c, discussed severing unconscionable parts of agreements.

The analysis of whether a contract is severable with regard to conditions may also vary by the type of contract involved. For example, with respect to conditions, it appears that construction contracts are generally entire. But employment contracts appear to be severable in most cases, often by pay periods. Of course, some employment contracts--such as a contract to teach a long academic course--might not be severable into smaller periods. The severability of sale of goods contracts is often controlled by statutes. This will be discussed in Section 9.5b below.

The most important effect on contract performance when a court finds that a contract is severable is that a problem with conditions as to one part of the contract will not affect the rest of the contract. So failure of a condition to occur as to one part of the contract does not affect the rest of the contract. Suppose a party fails to fulfill a condition by failing to perform with respect to one part of a severable contract. Despite this failure, the party can still perform the rest of the contract, fulfill conditions as to the rest of the contract, and cause the duties that depend on those conditions to become due. Of course, the party whose duty has not become due as to one part of a severable contract has no duty to perform as to that part of the contract. And that party also has a right to a remedy for any damage caused by the other party's failure to perform that part of the contract--a remedy for the other party's breach.

For example, in the severable watch repair contract above, suppose the repairer substantially (but not completely) performed the repair of the first watch, and failed to perform the second watch repair at all. In that case, the watch owner would be obligated to pay for the repair of the first watch, but not for the repair of the second watch. If the watch owner did not pay for the repair of the first watch, that would be a breach of the contract, and the repairer could ask the court for a remedy. But the watch owner would have the right to ask a court for a remedy to compensate him for two breaches:

(1) the minor breach of the repairer in failing to completely fix the first watch; and (2) the material breach of the repairer in failing to substantially fix the second watch. The following Case Study is another example of the doctrine of severability of contracts.

*** ***CASE STUDY 211***

FACTS Better Homes Construction Company agrees to build 10 houses for the Queen Group, a local real estate developer, on some land the Queen Group owns outside Battambang. The parties agree that the price for the construction will be $30,000 per house, for a total price of $300,000. The contract contains an arbitration clause.

Better Homes completes four of the houses. However, after starting the fifth house, Better Homes receives an offer to build 50 houses for the Big White Villa Company immediately! Better Homes decides that it must seize the opportunity to profit from this much larger contract, even though it will mean breaching the contract with the Queen Group. Better Homes removes its workers from the Queen Group work site and starts work on the Big White Villa houses.

Better Homes admits that it will have to pay any damages caused by its failure to build the last six houses for the Queen Group. But it asks the Queen Group for payment for the four houses that were completed. However, the Queen Group says it has no obligation to pay anything under the contract, because Better Homes failed to substantially complete the 10 houses. Better Homes asks the arbitrator for help.

QUESTION OF LAW Has the duty of the Queen Group to pay for the four houses that Better Homes built become due?

DECISION Yes. The Queen Group's duty to pay for these four houses has become due, because this contract was severable into 10 parts, and Better Homes substantially completed four of those parts (four houses).

When a contract is severable, the failure of a condition to occur as to one or more parts does not affect the performance of the remaining part or parts. Contracts are severable if the contract can fairly be divided into more than one corresponding part. Specifically, many jurisdictions say that contracts are severable if the performance by each party can be divided into more than one part; the number of parts due from each party is the same; and the performance of each part by one party appears to be the agreed exchange for the performance of the corresponding part by the other party.

In this case, the contract said that Better Homes was required to build 10 houses for the Queen Group for $30,000 each. This is a severable contract, because the performances can be divided into more than one part (10 houses, 10 payments of $30,000); the number of performances due from each party

is the same (10); and the performance of each part is obviously the agreed exchange for the performance of the corresponding part by the other party (one house in exchange for $30,000). In addition, in this contract, the performance by Better Homes in building the houses will be an implied-in-law condition precedent to the duty of the Queen Group to pay for the homes, since the building will require substantial time, but the payments can occur in an instant.

Here, Better Homes built four of the houses required by the contract, but not the other six. Because the contract is severable, Better Homes has fulfilled the condition precedent to the Queen Group's duty to pay for those four houses, and that duty is due to be performed. Of course, the Queen Group has no duty to pay for the six houses Better Homes failed to build. And as Better Homes admitted, the Queen Group also has the right to ask the arbitrator for a remedy for any damages caused to it because of Better Homes' failure to build the last six houses, which was a breach of the contract.

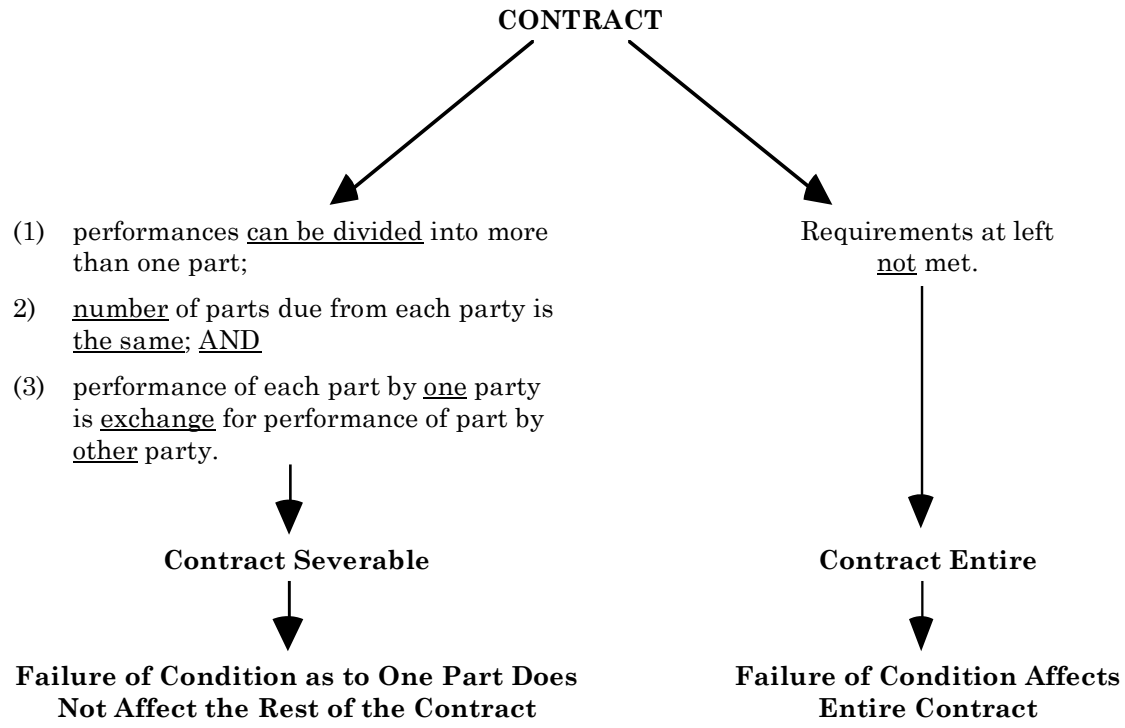
The situation in Case Study 211 creates an interesting issue with regard to remedies. Obviously, if the remedy in Case Study 211 was specific performance--actually ordering Better Homes to perform the rest of the contract--then Better Homes would be unable to follow its contract with the Big White Villa Company! Courts in common law jurisdictions will generally not order specific performance in cases like this. The main reasons are that those courts do not generally wish to get involved in supervising the performance of service contracts, and that ordering a party to pay money damages usually seems adequate to compensate injured parties in these contracts.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains further discussion of what remedies courts may choose in different situations.

The following chart shows some basic rules about how severability of contracts affects contract performance.



Illustration: How Severability of Contracts Affects Contract Performance with Regard to Conditions



*** ***WHY IS THIS IMPORTANT?*** Why does the law say that the failure of conditions as to one part of a severable contract does not affect the performance of the rest of the contract?

The basic reason for this rule is to help parties who perform parts of severable contracts to avoid the risk of forfeiture and other hardships. In this way, the rule about severability is similar to the rule about substantial performance, which was discussed in Section 9.4c, above. By definition, severable contracts involve more than one separate performance by a party. In fact, such contracts often involve a long series of performances, as in construction contracts like the one in Case Study 211. In situations like these, the party who must perform first will often have problems if he must perform the whole contract before he can receive any compensation from the other party. This may create financial problems for such parties, because they may need money to perform the contract, and to survive during the period they are performing it--just as an employee might have difficulty if he was paid only at the end of every year of work.

Of course, if a party performed each part of a severable contract at the same time and the same rate--such as if Better Homes had built all 10 houses at the same time--then that party might do a lot of work but still fail to achieve substantial performance as to any one part of the contract! In that situation, this rule would not help parties like Better Homes, although such parties could

still ask for restitution of what they had provided to the other party under the doctrine of quasi-contract. Of course, that sort of remedy is often not as good as a remedy under the contract itself. Parties who plan to perform contracts in this way may choose to include a contract clause that says they will be paid some part of what they will receive under the contract at certain points during their performance, in order to reduce the risk of forfeiture. For example, a builder like the one in Case Study 211 might include a clause saying he will be paid some portion of the contract price when all the foundations are laid. And this may also be done where contracts are entire, and cannot be severed, but still involve long performances which cause parties to want some protection from the risk of forfeiture.

In addition, if severable contracts were not treated in this way, it might actually discourage parties from making such contracts, and reduce economic activity. The reason is that parties would be taking a great risk if they made a contract like the one in Case Study 211. They might have to wait a long time to receive any payment, with no assurance that they would ever be paid under the contract, if for some reason they were unable to perform the whole thing. Of course, as noted above, such parties might be able to get restitution under the doctrine of quasi-contract, even if they could not recover under the contract itself. And they might have no other choice except to try to do so, if they chose to perform each part of the contract at the same time and the same rate. But as noted above, that sort of remedy is often not as good as a remedy under the contract itself.

9.4l Conditions of Approval Are Subject to Certain Limits

Sometimes contracts contain express conditions that say that the duty of one of the parties to perform depends on the approval of that same party, or the approval of a person who is not a party to the contract (a "non-party"). In other words, such contracts say that the duty of a party does not become due for performance unless that party or someone else approves the performance of the other party. For example, a contract might say that a buyer in a sale of goods contract has no duty to accept a shipment of goods unless he "approves" their quality.

Where there are conditions of approval, the law says there are certain limits on the ability of parties to cause the conditions to fail, and to prevent the duties that depend on the conditions from becoming due. When many courts analyze these conditions, they divide them into conditions of approval by a party to the contract, and conditions of approval by a non-party.

Where there is a condition of approval by a party to the contract, common law jurisdictions say the party cannot have complete discretion to disapprove, or else his contract promise is illusory, and there is no consideration. Assuming there is an enforceable contract, it appears that many jurisdictions say that conditions of approval by a party that involve matters of aesthetics and taste will fail if the evaluating party

honestly disapproves of the performance. By contrast, it seems that conditions of approval by a party that involve matters of practical or utilitarian standards that can be measured more objectively will fail only if the evaluating party is reasonable in rejecting the performance.

Where there is a condition of approval by a non-party, many courts first ask whether there will be a forfeiture by a party if the non-party disapproves his performance. If there will be no forfeiture, it appears that the condition will generally fail unless fraud or collusion was involved in the rejection of the performance. But if there will be a forfeiture, then many courts ask whether the condition involves a matter of aesthetics and taste and whether the parties chose a special non-party to evaluate the performance (as opposed to a non-party chosen from a group of many who were qualified to analyze the performance). If the condition involves a matter of aesthetics and the parties chose a special non-party to analyze it, then the condition will fail if the analyzing party honestly disapproves of the performance. In all other situations involving forfeitures, it appears that courts examine four factors in deciding whether the non-party's rejection will actually cause the condition to fail. These factors are: (1) the size of the potential forfeiture; (2) the nature of the performance involved (aesthetic or utilitarian); (3) whether the non-party was reasonable in rejecting; and (4) the relevant expertise of the non-party.

Obviously, these rules are not simple, and they also will not apply the same way in every jurisdiction. Therefore, it is important to check the local law in the jurisdiction relevant to a contract that contains such a condition of approval.

When a party wrongly disapproves a performance under these rules, the courts say that the condition is excused, and any duty that depends on it becomes due even though the condition has not been fulfilled. In a way, this situation could be compared to the situations where a party wrongfully prevents the fulfillment of a condition, or where a party is estopped by his own actions from claiming that a condition has not been fulfilled. In all three of these situations, one party has done something that the law believes would make it unfair to expect the other party to fulfill a condition. Wrongful prevention was already discussed in Section 9.4h, and estoppel was discussed in Section 9.4i.

(1) Conditions of Approval by Parties to the Contract

If the condition is to be approved by a party to the contract, then courts in many jurisdictions will examine the three limits discussed below to see the effect of a disapproval. If the condition of approval violates the first limit below--that there actually be some limit on the party's discretion to disapprove--then there will be no contract in common law jurisdictions because of a lack of consideration. If the disapproval of such a party does not follow the second limit, which basically says that disapprovals about aesthetic matters must be honest, or the third limit, which basically says that disapprovals

about utilitarian matters must be reasonable, then the condition will be excused, and the duty that depends on it will become due.

(1) First Limit: In common law jurisdictions, a party to a contract cannot have complete discretion to disapprove of the other party's performance, or there is no consideration, and the agreement will generally be unenforceable. Where an agreement contains a condition of approval by a party to the contract, common law jurisdictions say the party cannot have complete discretion to disapprove, or else the agreement lacks consideration and is generally unenforceable.

The important question here is whether the contract actually gives the party complete discretion to disapprove. If the agreement does not actually say that the party has complete discretion, it appears that courts will generally assume there is some limit on the party's discretion to disapprove. Courts then proceed to the second and third limits below. But suppose an agreement actually says something like the party "may disapprove for absolutely any reason whatsoever," or that the party's "discretion to disapprove is completely unlimited." Then a court may find that the agreement really places no limits on the party's discretion to disapprove of the other party's performance. The problem with an agreement like that is that it means the promises of the party with the power to disapprove are actually illusory. They are illusory because they do not actually promise anything. In a situation like this, the party with the power to disapprove has complete power to choose not to perform the agreement: he can disapprove the other's party's performance, for any reason, and he will have no contract obligation at all! In that case, common law jurisdictions say that there is no consideration, and therefore no enforceable contract, as discussed in Chapter 3 ("Consideration"), Section 3.5d.

For example, suppose an agreement for the sale of 1,000 pens contained a clause that said "Buyer shall have no duty to pay for any of the pens unless Buyer, in his absolute and unlimited discretion, approves the pens." In a situation like that, it would appear that the buyer has complete discretion to disapprove of the pens for any reason. That means that the buyer has not really agreed to do anything in the agreement, since he has complete power to not perform it, merely by disapproving of the pens. So common law jurisdictions would say that there is an illusory promise, no consideration, and no contract. But if the agreement merely said that the "Buyer shall have no duty to pay unless he approves the pens," it seems that a court would probably imply that there was some limit on the buyer's discretion, and proceed to examine the second and third limits below.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.5d contains further discussion of why illusory promises generally do not meet the requirement of consideration in common law jurisdictions.

(2) Second Limit: Many jurisdictions say that conditions of approval that involve matters of aesthetics and taste will fail if the evaluating party

honestly disapproves of the performance. When a contract contains a condition of approval by a party to the contract, and the approval involves a matter of aesthetics, it appears that many jurisdictions say the party has the right to disapprove of the other party's performance--and prevent his own duty of performance from becoming due--as long as he is honest in disapproving of that performance. If the party honestly disapproves of the other party's performance, then the condition will fail, and the duty that depended on that condition will not become due. But if a court decides that the party's disapproval is not honest, then the condition will be excused, and the duty that depended on the condition will become due.

For example, if a young singer agrees to sing at a nightclub in exchange for a fee to be paid by the club owner, the contract may say that the owner's payment will not be due unless the owner "approves" of the performance. That would be a condition involving an aesthetic matter. If the club owner honestly disapproves of the singing, then the owner's duty to pay will not become due.

There are two important elements to this limit:

(a) the limit applies only where matters of aesthetics and taste are involved;

and (b) a disapproval must be honest in order to cause the condition to fail.

Both of these elements are discussed below.

(a) Matters of aesthetics and taste are basically those that involve personal opinions about what is beautiful, or what has artistic value. In other words, such matters generally relate to "art," or at least to items that have some element of art in them. The quality of such matters cannot usually be measured objectively. Examples of such aesthetic matters are approvals relating to the quality of painting, sculpture, dance, music, or literature. Such things have no function that can be easily measured or defined. So it can be difficult to say what is "good" and has value, and what is "bad" and has little value. Of course, such items do generally have some monetary "value." But this appears to reflect the opinions of some group of people, rather than any quality that can be clearly measured. By contrast, matters with mostly utilitarian or practical qualities generally have functions that can be measured more objectively. Examples include tools, roads, chemicals, most machines, and many kinds of work.

For example, suppose Chuktema hired a painter to paint a portrait of his wife, and the contract contained a condition of approval. That would be a condition related to an aesthetic matter, since the quality of such a painting involves personal opinions that cannot be measured objectively. If Chuktema disapproved of the final painting, and his disapproval was honest, the condition would fail, and Chuktema's duty to pay would not become due.

However, if Chuktema hired the same painter to paint the walls of his house white, this would probably not be a matter of aesthetics. The reason is that it is much easier to measure the value or quality of basic wall painting done by a professional painter than it is to measure art, such as the painting of Chuktema's wife. So a court would probably say that the wall painting job was a practical or utilitarian matter, and require that any disapproval be reasonable, as discussed below.

Of course, some matters have both aesthetic and utilitarian aspects! For example, items like buildings, cars, clothing and food obviously have very practical uses. But part of their quality or value also relates to aesthetic factors, such as their attractiveness or taste. Many kinds of work may also have both practical and aesthetic elements. In any case, although it may sometimes be difficult, courts might try to decide whether a condition of approval concerns a matter that is mostly aesthetic or mostly utilitarian, and then apply the appropriate rule.

(b) Where aesthetics are involved, disapprovals must be honest if they are to cause a condition of approval to fail. "Honest" in this situation simply means that the disapproving party truly does not like the performance of the other party. Obviously, this is a subjective standard, since it depends on what is in a particular party's mind.

For example, in the portrait painting above, a disapproval by Chuktema would cause the condition of approval to fail as long as Chuktema honestly--truthfully--did not like the painting. It would not matter whether Chuktema's opinion was reasonable, whether Chuktema knew anything about art--or whether anyone else in the entire world agreed with him!

It might seem that this "honest" standard would almost always be met, since parties do not generally disapprove things unless they honestly dislike them. However, it is possible that a party might disapprove a performance even though he does not really dislike it. For example, a party like Chuktema might disapprove the painting not because he did not like it, but because he no longer had the money to pay for it. In addition, Chuktema might disapprove the painting not because he disliked it--but because he decided he had agreed to pay too much money for it! Chuktema might also make such a contract merely in order to hurt the painter, perhaps because he did not like him. And there may be other situations where a party like Chuktema might "dishonestly" disapprove a performance.

Unfortunately, it can be difficult for courts to decide the real reason a party disapproves a performance. Often, the only evidence will be the testimony of the party himself about his own opinions, although there may be other witnesses or documents with relevant information. Even though it is difficult, courts must try to decide the real reason the party disapproved--which may or may not be the reason that the party claims he disapproved. For example, Chuktema may claim he rejected the painting because he honestly

disliked it. But if the painter finds a letter from Chuktema to a friend admitting that he liked the painting but could not afford it, that might show that Chuktema's disapproval was not honest. In that case, the condition would be excused, and Chuktema's duty to pay would become due. However, evidence like this is rare, and often courts must base their decisions simply on whether they believe what the disapproving party says or not.

*** ***WHY IS THIS IMPORTANT?*** Why does the law say that disapproval will cause a condition of approval related to aesthetic matters to fail as long as the disapproval is honest?

This rule may seem unfair to the party whose performance is subject to such disapproval. Obviously, such parties are taking a big risk of forfeiture. They might work hard on a performance that is disapproved, and the other party's duty to pay will not become due. However, it would seem that the parties in these cases are really assuming that risk when they make the contract. That is because they know from the start of the performance that they will not be paid unless the other party likes their work or product. If such parties do not wish to take this risk, they should not make such contracts. And of course, as noted elsewhere, courts do generally wish to enforce contracts in the way the parties intended them.

For similar reasons, it may be difficult to get restitution in such cases, because it may be difficult to show much unjust enrichment--if the disapproving party honestly dislikes the performance, how has he been enriched? And again, where a party assumes this risk, any enrichment may not be unjust. Of course, if a party has clearly given something of value to another party--such as a structurally perfect building whose appearance the disapproving party honestly does not like--it would seem that a court would be more likely to try to provide restitution to the party who has given the benefit.

On the other hand, these contracts obviously give a lot of power to the disapproving parties. It may be that these parties need this power. That is because, if those parties had to agree to pay for aesthetic performances before they knew whether they liked the performances, then they would be taking a big risk that they would not like the results! So such parties may choose to put conditions of approval in their contracts.

In a way, this requirement of honesty in disapprovals involving aesthetic matters is comparable to the standards of the duty of good faith in contract performance, which was discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and which will be discussed again in Section 9.5c, below. As the reader will recall, the duty of good faith that many jurisdictions say is part of all contracts basically means that parties have an obligation to be honest and not seek unfair advantage in their contracts.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3j contains further discussion of the duty of good faith that many jurisdictions say is present in all contracts.

(3) Third Limit: Many jurisdictions say that conditions of approval that involve practical or utilitarian matters will fail if the evaluating party is reasonable in rejecting the performance. Sometimes a contract contains a condition of approval by a party to the contract, and the approval involves a practical matter. In that situation, it appears that many jurisdictions say the party has the right to disapprove of the other party's performance--and prevent his own duty of performance from becoming due--as long as he is reasonable in disapproving of that performance. If such a party reasonably disapproves of the other party's performance, then the condition will fail, and the duty that depended on that condition will not become due. But if a court decides that the party's disapproval is not reasonable, then the condition will be excused, and the duty that depended on the condition will become due.

For instance, suppose Chuktema in the house painting example above disapproved of the painter's work in painting Chuktema's walls white. Suppose Chuktema said that his reasons were that the painting was very uneven, and that the painter had actually missed large parts of the wall completely. In that situation, a court would be likely to find that Chuktema's disapproval was reasonable. In that case, the condition of approval in the contract would fail, and Chuktema's duty to pay for the painting would not become due. Of course, the painter could try to recover restitution of the benefit he had given to Chuktema.

There are two important elements to this limit on conditions of approval related to practical matters:

(a) it applies only where practical or utilitarian matters are involved;

and (b) any disapproval must be reasonable.

These two elements are discussed below.

(a) Utilitarian or practical matters are basically those that have functions that can be measured objectively, as noted above. They tend to be things that are more obviously "practical" or "useful" than aesthetic things. Examples of such "practical" things include machines, tools, roads, chemicals, medicines, and most kinds of goods, as well as many kinds of work or services, such as truck driving. Of course, as also discussed above, in some situations it can be difficult for courts to decide whether a matter subject to a condition of approval is actually more "aesthetic" or more "practical."

(b) Many jurisdictions say that any disapproval must be reasonable in order to cause a condition of approval about practical matters to fail. What is "reasonable" in a particular case will depend on all the circumstances of that case. Of course, the reasonable standard is

an "objective" one, since it depends on what a reasonable person in the situation of the disapproving party would do. In fact, this will generally be a more difficult standard for the disapproving party to meet than the "honesty" standard discussed above. This is because the disapproving party cannot disapprove of a performance merely for any honest reason at all, as he can with aesthetic matters. In fact, for the reasonable standard, it does matter what other people might do in a similar situation. The reasons for disapproval must be justifiable, to the extent a "reasonable" person might disapprove for the same reasons.

For instance, in the pen sale example above, if the buyer rejected the pens for reasons such as that they did not work well, or that the exterior surfaces of the pens were rough and uncomfortable to use, a court might find that those were reasonable reasons to disapprove. In those cases, the conditions of approval would fail, and the buyer's duty to pay would not become due.

But suppose the buyer rejected the pens merely because he decided he did not like pens anymore, or because he thought the pens would be able to speak French and they could not. Or suppose that he disapproved them without even looking at them. Those would be unlikely to be considered reasonable reasons for disapproving the pens. In those cases, the conditions of approval would probably be excused, and the buyer's duty to pay would become due.

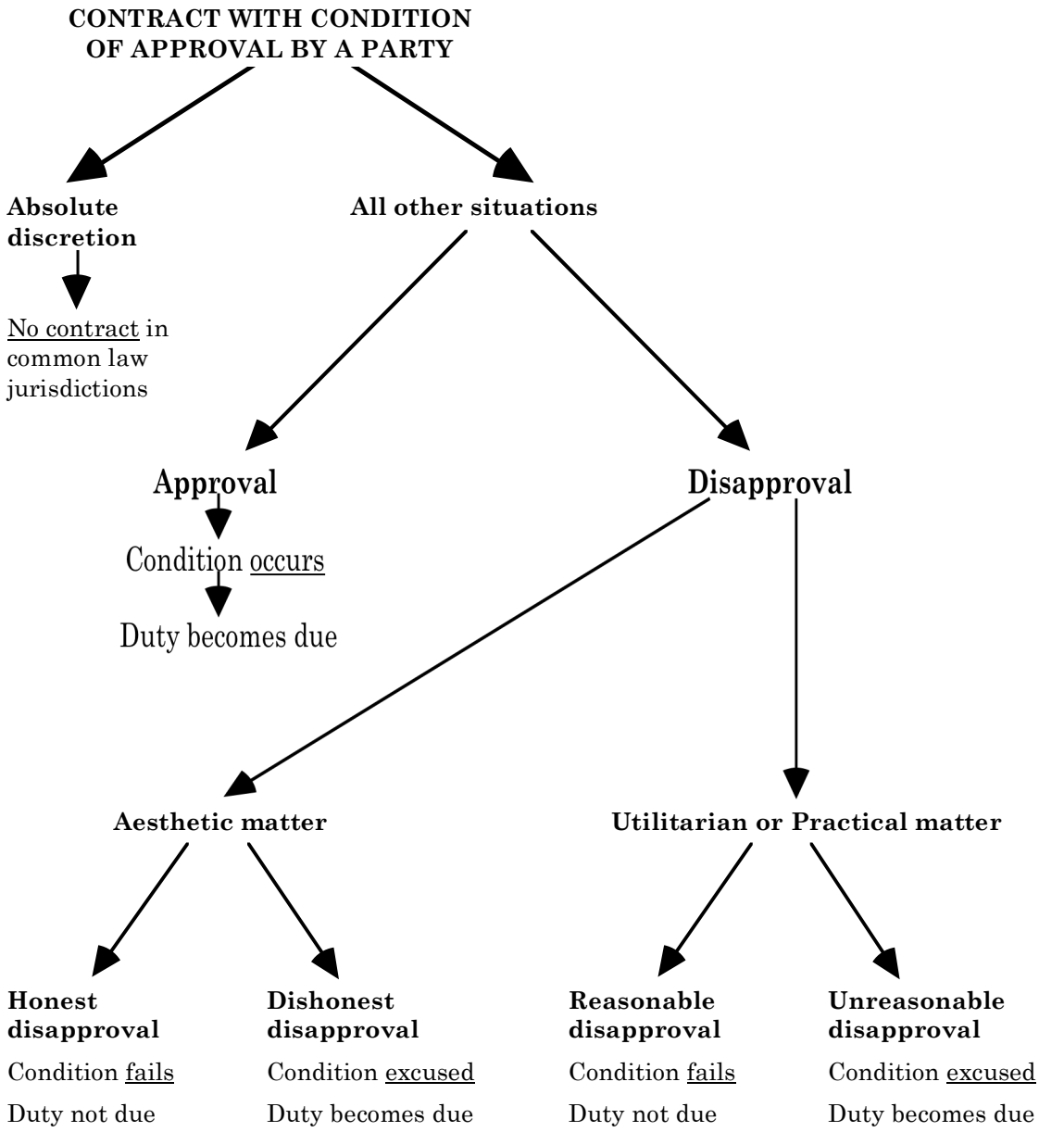
Just as the "honest" standard discussed earlier was somewhat comparable to the duty of good faith, this "reasonable" standard is somewhat comparable to the duty of fair dealing that some jurisdictions imply in contracts. Like that duty of fair dealing, this is an objective standard based on what reasonable parties would do in performing a particular contract. And like that duty, this standard is particularly useful for evaluating performance in commercial situations.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3j contains further discussion of the duty of fair dealing that many jurisdictions say is present in contracts.

The following chart shows some basic rules about limits courts may apply where a contract contains conditions of approval by a party to the contract.



Illustration: Limits Where a Contract Contains Conditions of Approval by a Party to the Contract



(2) Conditions of Approval by Non-Parties

In some cases, a condition of approval in a contract is to be approved by a non-party. In those situations, courts in many jurisdictions will examine the three rules discussed below to see the effect of a disapproval.

The first rule depends on whether there will be a forfeiture by a party if the non-party disapproves his performance. If there will be no forfeiture, it appears that the condition will generally fail unless the non-party actually

committed fraud or collusion in disapproving the performance. But if there will be a forfeiture, courts proceed to the second rule.

The second rule depends on whether the condition involves a matter of aesthetics and whether the parties chose a special non-party to evaluate the performance (as opposed to a non-party chosen from a group of those qualified to analyze the performance). If the condition involves a matter of aesthetics and the parties chose a special non-party to analyze it, the condition will fail if the analyzing party honestly disapproves of the performance. In all other situations, such courts proceed to the third rule.

The third rule analyzes whether the disapproval was proper based on four factors: (1) the size of the potential forfeiture; (2) the nature of the performance involved (aesthetic or practical); (3) whether the non-party was reasonable in rejecting; and (4) the relevant expertise of the non-party. These three rules will be discussed below.

(1) First Rule: If a disapproval by a non-party will cause no forfeiture, then it appears that the condition will not be excused unless the disapproval is actually the result of fraud or collusion. This first rule depends on whether the disapproval will cause a forfeiture. If the disapproval will cause a forfeiture, then courts proceed to the second rule, which is discussed below.

But if it will not cause a forfeiture, then courts in many jurisdictions appear to say that only fraud or collusion will excuse the condition. In other words, unless fraud or collusion is present, the condition will fail, and the duty that depends on it will not become due.

The two important elements of this first rule are:

(a) whether there will be a forfeiture; and

(b) whether there is fraud or collusion.

These elements will be briefly discussed below.

(a) The first element of this rule is whether the disapproval of the non-party will cause a forfeiture. Forfeiture was already explained in Section 9.3c above, which discussed express conditions, and Section 9.4j, which discussed impossibility as an excuse for conditions. As noted above, a forfeiture is basically a loss of something to another person because of a breach of contract or other failure to act as required by law, with no adequate remedy for the party suffering the loss. Because courts generally do not like forfeitures, they look more closely at disapprovals that will cause them. But if a disapproval will not cause a forfeiture, then only fraud or collusion will excuse the condition.

For example, suppose Sokung agreed to buy 50 boxes of ordinary computer paper from Thida for a certain price. Suppose the contract also said Sokung would have no duty to pay unless Vipheak approved of the paper. In that situation, even if Vipheak does not approve the paper, there is little risk of forfeiture. That is because Thida can simply take the paper back and sell it to someone else. In other words, Thida will probably not suffer great damage, except perhaps lost profits if Thida cannot sell the paper for as high a price as Sokung had agreed to pay. But if the paper was a very special kind that Thida had manufactured particularly for Sokung's factory, then there might be a real risk of forfeiture if Vipheak disapproved the paper. The reason is that Thida might have a very difficult time selling her special paper to anyone else. A disapproval by Vipheak might mean Thida would have no way to be compensated for all her work--since the failure of the condition of approval would mean Sokung's duty to pay for the paper would not become due! So in that situation, courts would look more closely at the condition, and would proceed to the second rule explained below.

Another important situation where courts ask whether a forfeiture would result is where there is a condition of approval in a construction contract, like the one in Case Study 210. In that Case Study, a construction contract contained a condition of approval of a house by an architect named Seng Meng. Unfortunately, Seng Meng died after the house was finished but before he could sign the certificate of approval. In that situation, the builder would have suffered an obvious forfeiture if the condition was not excused. This is because the builder would have lost all the work he put into the house and had no adequate legal remedy, since Socheatra's duty to pay for the work depended on the failed condition. So the condition in that case was excused under the doctrine of impossibility. And it probably could also have been excused under the rules about conditions of approval, since there is no way a dead architect can meet the other standards discussed in this Section (such as honesty or reasonableness).

However, if there was no risk of forfeiture--such as if the condition of approval merely said that the architect was to approve the construction plans before Big White even started to build--then it appears that even the architect's death would not have excused the condition, unless fraud or collusion was involved. In that case, the condition would not have been excused and Socheatra's duty to pay would not become due. But courts would not require Big White to perform the construction either, since the company's duty would probably be discharged by impossibility. These problems were also discussed in Section 9.4j above, and they will be discussed again in Section 9.8a, below.

(b) Where forfeiture will not occur, conditions of approval by non-parties will fail as a result of a disapproval only if fraud or collusion is involved. "Fraud" basically means the intentional use of deception or dishonesty to cheat or harm another person. In this area, fraud would probably occur if the non-party or the party whose duty depended on

the condition intentionally used deception or dishonesty to cause the disapproval. "Collusion" is basically an agreement to commit fraud or to obtain something illegally. Collusion would probably occur if the non-party and the party whose duty depended on the condition decided together that the non-party would disapprove the performance, either because the party paid money to the non-party, or for some other improper reason. It appears that the doctrines of fraud and collusion overlap, and that both ideas are similar to the "honesty" standards discussed above.

For instance, in the paper sale example above, suppose Sokung and Vipheak agreed that Vipheak--in exchange for a secret payment from Sokung--would never approve the paper. That might be collusion, and the condition of approval might be excused even though no forfeiture was involved. But in the absence of situations like that, even arbitrary or unreasonable disapprovals by the non-party will not excuse the condition.

(2) Second Rule: If forfeiture is involved, the condition involves a matter of aesthetics, and the parties chose a special non-party to evaluate the performance, the condition will fail if the analyzing party honestly disapproves the performance. Where there is a risk of forfeiture, many courts next ask whether the condition involves aesthetics, and whether the parties to the contract chose a special non-party to evaluate the performance. If the answers to both of those questions are yes, then courts say the non-party's disapproval will cause the condition to fail as long as the disapproval is honest. In all other situations--that is, in all situations except where a special non-party is evaluating aesthetics--courts proceed to the third rule discussed below. So assuming forfeiture is involved, there are really three elements in this second rule:

(a) whether the condition involves aesthetics;

(b) whether the parties chose a special non-party to evaluate the performance; and

(c) whether the disapproval was honest.

Elements (a) and (c) were already discussed above. Element (b) is discussed below.

This rule applies only where a "special" non-party is evaluating matters of aesthetics. It appears that a "special" non-party in this situation means one the parties selected because of his special qualifications to evaluate whatever aesthetic performance is involved in the contract. By contrast, parties who are not "special" in this way are those chosen from a group of persons qualified to analyze the performance. Courts seem to ask whether it is clear the parties wanted the evaluator they chose because that person was especially or uniquely qualified--or whether they simply wanted someone from a group of qualified persons, and the non-party described in the contract happened to be the person they got.

For instance, in the example above where Chuktema hired a painter to paint a portrait of Chuktema's wife, suppose the contract said that Chuktema's duty to pay depended on approval by Sakorn. And suppose Sakorn was a famous art expert chosen by the parties because he knew more about portraits than anyone else in Cambodia, and that Sakorn disapproved the painting because he honestly thought it was of poor quality. If the painter finished the painting before being paid, there would be a risk of forfeiture, since a disapproval could mean the painter would not be paid for all his work. In that case, many courts would ask whether aesthetics were involved, whether the parties chose a "special" non-party to evaluate the performance, and whether that non-party's disapproval was honest. First, aesthetics are involved, since portraits are a form of art that cannot be objectively measured. Second, it appears that Sakorn was chosen for his special abilities in judging portraits. Third, it appears that his disapproval was honest. Therefore, in this case, it appears that a court would find that the condition of approval in the contract would fail. So Chuktema's duty to pay would not become due. Of course, if Sakorn had been chosen merely because he was one of hundreds of graduates of an art school, this second rule would not apply, and the court would proceed to the third rule explained below.

(3) Third Rule: If forfeiture because of a non-party disapproval is involved in any other situation--any situation that does not involve a special non-party evaluating aesthetics--then many courts ask whether the disapproval was proper based on four factors. If there is a risk of forfeiture, but the situation discussed above involving aesthetics and special non-parties does not apply, then courts in many jurisdictions consider four factors in deciding whether a disapproval was proper. The four factors are:

(a) the size of the potential forfeiture;

(b) the nature of the performance involved (aesthetic or practical);

(c) whether the non-party was reasonable in disapproving;

AND (d) the relevant expertise of the non-party.

Each of these factors will be briefly discussed below.

(a) The first factor courts consider is the size of the potential forfeiture. This factor basically asks how much the party whose performance is being evaluated will lose as a result of a disapproval of the condition. The more this party will lose, the more closely courts examine whether the disapproval was proper. In other words, the larger the potential forfeiture, the more likely the disapproval will be found to be improper.

For instance, in the painting example above, if the painter had spent only 10 minutes making a quick sketch for Chuktema, there would probably not be a large forfeiture if Sakorn disapproved--the only loss would be 10 minutes of the painter's time. But if the painter had spent several weeks on

a careful, detailed painting, there could be a much larger forfeiture if Sakorn disapproved.

(b) The second factor courts consider is the nature of the performance that is being disapproved--that is, whether it is practical or aesthetic. This subject was discussed in detail above. As noted above, the non-party is allowed more discretion to disapprove of a performance related to aesthetics than a performance related to practical matters.

(c) The third factor courts consider is whether the non-party was reasonable in disapproving the performance. This subject was also discussed in detail above. If a disapproval is made for justifiable reasons--reasons that a reasonable person might give--then it is much more likely to be considered proper, and to cause a condition of approval to fail.

(d) The fourth factor courts consider is the level of expertise of the non-party who is doing the evaluating. If the non-party is a well-known expert in a certain field--as in one of the painting examples above, where Sakorn was a famous art expert--then the non-party usually has more discretion to disapprove. But if the non-party is merely one of a larger group of competent persons--such as the situation where Sakorn was merely one of many recent graduates of art school--then the non-party usually has less discretion to disapprove.

*** ***CASE STUDY 212***

FACTS One day the Minister decided it was time to build a new Ministry building. So he asked his assistants to conduct a bidding process for the construction of a large new building. The result was a contract between the Ministry and the Big Bear Beams Construction Company for the Company to build the building within the next year. One clause in the contract said that the Ministry would have no duty to pay unless the finished building was approved by an engineer named Lam. Lam was only one of many qualified local engineers the parties thought about when they made the contract, but he happened to be the first one they were able to contact when they were making the agreement.

The Company worked on the building for one year. At the end of that time, the Company showed the finished building to Lam, and asked whether he would approve it. Lam examined the large building for about two weeks. Then he told the Company that some of the doorknobs on the interior doors did not work, and that he felt the building was unsafe because "it's too big." For these reasons, Lam disapproved the building. The Company is unable to persuade the Ministry to waive the condition of approval. So the Company asks the court for help.

QUESTION OF LAW Will the condition of approval in this contract be excused?

DECISION Probably. The condition of approval in this contract will probably be excused because Lam's disapproval of the building was probably not proper.

Where there is an express condition of approval by a non-party, courts first ask whether there will be a forfeiture if the condition fails. If there will, courts ask whether the situation involves a special non-party evaluating aesthetic matters. If it will not, courts then examine four factors to see if the disapproval was proper: the size of the forfeiture; the nature of the approval (aesthetic of practical); the reasonableness of the disapproval; and the expertise of the disapproving party.

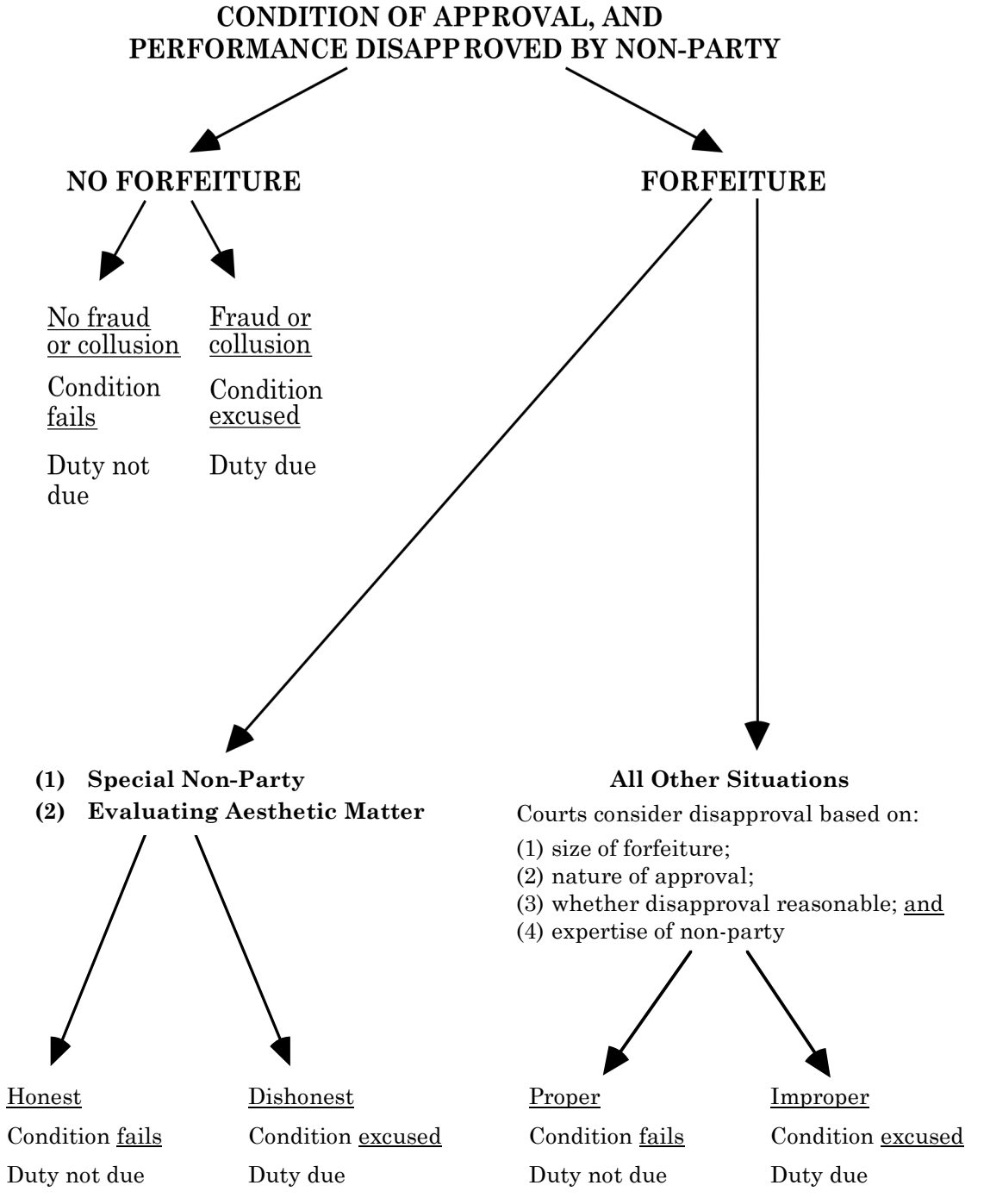
In this case, Lam was an engineer who was asked to approve a large new building that the Big Bear Beams Company built for the Ministry. The Ministry's duty to pay is subject to the express condition that Lam approve the finished building. If the condition fails, there will be a large forfeiture, since the Company spent an entire year working on the building, and it risks a forfeiture of all its efforts during that year. In addition, this case does not involve a special non-party evaluating aesthetic matters. Although there may be some aesthetic qualities in a building, engineers are not generally selected to evaluate those, but to evaluate more practical aspects. And in any event, Lam was not a "special" non-party, since he was only one of many qualified persons who might have evaluated the building, and the parties did not choose him for any special reason.

Therefore, the court will examine the four factors listed above to see if Lam's disapproval was proper. First, the forfeiture will be large if the condition fails, as discussed above. Second, the approval sought is primarily practical or utilitarian, since an engineer like Lam is likely to be asked to evaluate the more practical aspects of a building--which is what he did in basing his disapproval on structural issues such as safety and whether the doorknobs worked. Third, Lam's disapproval is probably unreasonable. It may appear reasonable because he spent a fairly long time inspecting the building (about 2 weeks). But the reasons he gave--that a few doorknobs did not work and that the building was "too big"--are probably not reasonable justifications for his disapproval of this kind of project. Finally, Lam will probably not have great discretion to disapprove, since he is not a well-known expert, but merely one of a number of qualified persons the parties might have chosen to evaluate the building.

Considering all the factors, it seems likely that a court would find Lam's disapproval was not proper. Therefore, the condition of approval will probably be excused, and the Ministry's duty to pay will probably become due. Of course, if the doorknobs really are defective, the Ministry is entitled to a remedy for that kind of minor breach.

The following chart shows some of the basic rules that many jurisdictions apply where a contract contains conditions of approval by a non-party.

Illustration: Basic Rules Where a Contract Contains Conditions of Approval by a Non-Party



9.5 Performance of Contract Duties in Particular Situations

Sections 9.3 and 9.4 discussed some basic rules about the performance of contracts, particularly about how promises and conditions affect contract duties. However, it is important to recognize that the rules explained in Sections 9.3 and 9.4 do not apply exactly the same way in all situations, or in all jurisdictions. In fact, some rules may not apply at all in a particular situation or jurisdiction. In addition, there are some special rules for particular situations. Therefore, it is important to check the local law relevant to any contract in order to see whether and how these rules operate.

This Section will discuss a few examples of special rules about contract performance that may apply in particular situations. Many jurisdictions have some special rules for certain types of contracts. Two important examples are construction contracts (discussed in Section 9.5a) and sale of goods contracts (discussed in Section 9.5b). And as noted above, there may also be other rules that affect contract performance in particular jurisdictions, such as the duty of good faith and fair dealing (discussed in Section 9.5c).

9.5a Performance of Construction Contracts

Performance problems often occur in construction contracts. In fact, some of the important rules discussed in this Chapter appear to have been developed because of problems in the performance of these contracts. For example, the rules about substantial performance as a way to fulfill implied-in-law conditions, which were explained in Section 9.4c above, were developed in this way. In general, these rules appear to work well in providing guidelines for the performance of construction contracts, and in helping to resolve fairly most disputes that occur. For example, Case Studies 198, 201, 205, 210, 211, and 212 deal with construction contracts.

However, there is one special problem that may occur in the performance of construction contracts, or similar service contracts. Specifically, there is a potential for forfeiture in such contracts if the builder provides substantial performance--but the contract contains an express condition requiring complete performance. As discussed in Sections 9.3 and 9.4 above, only complete performance will fulfill an express condition. This situation presents a real risk of forfeiture, because the builder could complete all of a very large project except one small thing, but not be paid under the contract for any of his work! And in fact, as explained in Section 9.3c above, this high potential for forfeiture in some cases is the reason courts are often reluctant to interpret a part of a contract as an express condition.

For these reasons, courts prefer to interpret the language of a contract so that there is no express condition. If that is possible, and there is only an implied-in-law condition, substantial performance will fulfill the condition, and the duty which depended on the condition will become due for performance. But if that is not possible, the law is left with the choice of

enforcing the regular rules about express conditions, or finding a new rule to save the builder from forfeiture.

This is a difficult problem. On the one hand, all jurisdictions want parties to respect the law, and that cannot happen if the law is not applied as it is written. In addition, courts want to enforce what parties put in their contracts--or else the parties cannot rely on their contracts! And express conditions do motivate parties to perform their contracts well. But on the other hand, courts do not enforce what the parties put in their contracts in a few special, limited cases, such as where the contract is illegal. And in fact, the express condition rule could cause injustice in some cases.

So some authorities believe that the law should consider a new rule for construction cases. For example, there might be a rule that it is against public policy for courts to enforce express conditions where the result would be a great forfeiture, and so in that case the substantial performance rule should apply. Or maybe there should be a rule that the express condition will be enforced if the builder can fix the problem without great economic waste. An example of great economic waste might be if the builder had to tear a house apart to replace all the pipes simply because he had used the wrong brand of pipe! If enforcing the express condition would cause that kind of waste, perhaps the condition should be excused (though a remedy would still be available for any breach of the builder's duty). Or perhaps courts should consider whether it violates the duty of good faith and fair dealing for a land owner to try to enforce an express condition in this situation, even though he may technically have the right to do so. Perhaps a violation of that duty should excuse the condition. It appears that some courts will apply some variations of these new rules in construction cases, though they may have trouble explaining why they are not following the general rule. What do you think the rule should be in these situations?

******* ***CASE STUDY 213***

FACTS A builder named Bun Ly agrees to build a new concrete villa for Mareth for a certain price. The contract says that Mareth's duty to pay is "expressly conditioned on Bun Ly completing the house exactly as specified in the Plans attached to this contract." Part of the Plans says that Bun Ly must build the house 15 feet from the back border of Mareth's land.

Bun Ly finishes the house on time, and everything is exactly as specified in the Plans--except that the house has been built 12 feet from the back border of Mareth's land! Mareth says the contract required that the house be completed exactly according to the Plans, and that he has no duty to pay. Bun Ly asks the court for help.

QUESTION OF LAW Has Mareth's duty to pay become due?

DECISION Maybe. Although the general rule says the duty has not become due, it appears that courts in some jurisdictions might say that Mareth's duty to pay has become due even though Bun Ly has not fulfilled the express condition, because Bun Ly risks a great forfeiture if the condition fails.

The general rule is that express conditions can be fulfilled only by complete performance. However, it appears that some courts will make an exception to this rule where there is a risk of a great forfeiture in construction cases.

In this case, the parties' construction contract contained an express condition saying that the owner Mareth's duty to pay for the work depended on complete performance by the builder Bun Ly according to the Plans attached to the contract. Bun Ly did finish building the house according to the plans--except that he built the house three feet from where the Plans specified. The general rule would say that Mareth's duty to pay has not become due.

However, it appears that some courts will make an exception because of the risk of great forfeiture. In this case, if Mareth's duty to pay does not become due, Bun Ly will receive nothing under the contract. And Bun Ly's error here is very minor. However, although it is a minor error, it would require great economic waste to fix--since Bun Ly would have to rebuild a large portion of a concrete house to do it! In that situation, it seems that some courts will excuse the express condition, and apply the doctrine of substantial performance. Applying that doctrine, Bun Ly has probably substantially performed, and Mareth's duty to pay has become due. Of course, if Mareth really has suffered any damage because of Bun Ly's failure to build the house in the right place--because of Bun Ly's breach--then Mareth is entitled to a remedy for that breach.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") discusses remedies courts may order when there is a contract breach.

9.5b Performance of Sale of Goods Contracts

Another important type of contract to which special performance rules may apply is sale of goods contracts. Many jurisdictions have special statutes that govern these contracts. These statutes may actually change some of the rules discussed in Sections 9.3 and 9.4 which relate to the performance of sale of goods contracts. The reasons these laws may modify the rules include helping parties to these contracts--especially businesses and governments--to conduct trade and other important activities efficiently.

This Section will briefly discuss a few examples of special rules which one of these statutes--the Uniform Commercial Code ("UCC") in the United States--contains for the performance of sale of goods contracts. Specifically, the Section will examine the UCC's special rules about (1) waiver and (2) tender of performance.

(1) Waiver in Sale of Goods Contracts

Waiver is one important area in which the UCC has special rules related to performance of contracts. The rules about waiver are different for sale of goods contracts because the rules about modification of contracts are different. The UCC allows parties to modify sale of goods contracts even if there is no new consideration for the modification, as long as the modification is made in good faith. This is true even though common law jurisdictions like those in the United States normally require consideration in order for such changes to be enforceable. This was already explained in Chapter 3 ("Consideration"), Section 3.7a.

The effects of this rule on the performance of contracts have also been explained above, in Section 9.4i of this Chapter. One important effect would appear to be that a party to a sale of goods contract could waive the right to receive the benefit of a condition in that contract, even if the condition was a material express condition. Another important effect would appear to be that a party could waive the right to receive a promised performance--the benefit of a duty of the other party--even if that performance was a material part of the contract! So it appears that the UCC permits parties to waive the rights to the benefit of both conditions and promises, as long as the change is made in good faith.

For example, suppose Sokvann made a contract to purchase 100 tons of tobacco from a rich and powerful merchant named Triv for a certain price. If the price of tobacco gets much higher before the delivery date, Triv will still be required to honor the contract as it is written, even though it has become a bad deal for him. But if Sokvann agrees to pay the same price but modify the quantity term to be 90 tons--perhaps because he hopes to persuade the rich and powerful Triv to enter into good deals with him in the future--that would be an enforceable modification under the UCC. This is true even though there is no new consideration, since Triv has promised to do nothing new. The effects of the modification would be that Sokvann has waived the right to receive 100 tons of tobacco, and that he has waived the right to the benefit of the condition concurrent to his duty to pay--which is that he receive 100 tons of tobacco before his duty to pay becomes due. So Triv will be required to deliver only 90 tons of tobacco, and if he does, Sokvann will still be required to pay the original contract price.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7a discussed the sale of goods exception to the general rule that common law jurisdictions require consideration for modifications of contracts.

(2) Tender of Performance in Sale of Goods Contracts

The UCC also has a number of special rules about the rights and duties of the parties when there is a tender of goods. Basically, these rules control what happens when the buyer says that the seller has failed to make

a proper tender of the goods. When that occurs, jurisdictions that follow the UCC apply the rules discussed below. Sometimes these rules are somewhat different from the general rules about performance discussed in Sections 9.3 and 9.4 above. Obviously, these differences will affect the rules about improper rejection of a tender (discussed in Section 9.4g). But as explained below, the differences may also affect the rules about severability (discussed in Section 9.4k), substantial performance (discussed in Section 9.4c), and other important subjects.

Some of these special rules are very complex, and this text cannot explain them completely. The material below is merely a general overview of some of the important rules about this subject in one particular statute (the UCC). Of course, as always, it is important to check the local law in the jurisdiction relevant to the contract.

The UCC's rules about the rights of the parties where there is some problem with a tender may be divided into three basic parts:

(a) how courts decide whether a contract is a "single lot" contract or an "installment" contract;

(b) the rights of parties to "single lot" contracts; and

(c) the rights of parties to "installment" contracts.

Each of these parts will be briefly discussed below.

(a) How courts decide whether a contract is a "single lot" contract or an "installment" contract -- Under the UCC, the rights of parties to sale of goods contracts differ depending on whether the contract is a "single lot" contract or an "installment" contract. The UCC says that all sale of goods contracts are single lot contracts except those that require or authorize the delivery of goods in separate lots, which are installment contracts. So single lot contracts are those that require tender of all the goods in one delivery, whereas installment contracts are those that require or allow tender of the goods in more than one delivery.

Contracts authorizing delivery in separate lots would appear to mean those that allow that kind of delivery either expressly or impliedly. This authorization might be implied where the circumstances of the contract indicate that is what the parties intended.

For example, suppose there is a contract for the delivery of a huge quantity of oil by railroad. If both parties know that trains that run on the relevant delivery route are never long enough to handle that much oil in one trip, a court would probably say the contract was an installment contract. The oil would have to be delivered in separate lots.

(b) The rights of parties to single lot contracts -- In single lot contracts, the general rule under the UCC is that the buyer has the right

to reject a tender of goods if that tender fails in any way to follow the terms of the contact. This rule is sometimes called the "perfect tender" rule, and it would seem to mean that the seller would not have the benefit of the substantial performance doctrine in sale of goods contracts.

However, so many limits have been imposed on this general rule that it appears the practical result is that courts often do not allow buyers to reject goods unless the non-conformity is serious--which is actually comparable to the substantial performance rule! So the "perfect tender" rule is not really an accurate name for the rule under the UCC. Even so, the UCC rules about single lots are probably more helpful to buyers overall, since the rules probably do give buyers more power to reject than they would otherwise have.

Specifically, in single lot contracts, the UCC gives a buyer three options when the tender of goods from the seller is "non-conforming"--does not conform to the contract--in some way. In that situation, the buyer may:

(1) accept the whole tender;

(2) reject the whole tender; or

(3) accept any "commercial units" of the tender and reject the rest.

A "commercial unit" would appear to mean any part that could be separated from the tender without causing commercial waste. For example, it might be proper to accept only half of a rice shipment, but not accept half of one car.

If a buyer accepts the whole tender, it appears that his duty to pay generally becomes due, although he may actually revoke his acceptance in some circumstances. That will be explained below.

If a buyer rejects the whole tender, and his rejection is not affected by any of the limits discussed below, then it appears that the rejecting party's duties under the contract are discharged. In other words, it seems that the rejecting party has the right to treat the non-conforming tender as a material breach. The buyer's duty to pay would not become due, since it depended on the fulfillment of the implied-in-law condition that was the seller's delivery, and the buyer could ask a court for a remedy to compensate him for the seller's breach. Discharge of duties in this way will be further discussed in Section 9.6b, below.

If the buyer rejected only part of the tender, and none of the limits below applied to that rejection, it would seem that the buyer's duty to pay would become due. Of course, the buyer would be entitled to a remedy to compensate him for the damage caused to him by the seller's breach.

As noted above, there are many limits on the general rule about tender of goods in single lot contracts. These are limits on the buyer's ability to reject the tender. It appears that these limits reduce the effect of the rule so much

that conditions in sale of goods contracts can often be fulfilled by substantial performance! This text briefly discusses five of these limits below.

First Limit: The parties may agree that a perfect tender will not be required. It appears that this kind of agreement could occur as part of the contract, or later, since modifications of sale of goods contracts do not require consideration under the UCC, as discussed above.

Second Limit: It appears that courts sometimes interpret contracts so that what looks like a minor non-conformity is not really a non-conformity. Some courts do this by examining the contract interpretation rules about the circumstances surrounding the contract, such as the course of performance, course of dealing, and trade usages, in order to find if a tender is really non-conforming. These rules were already discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3h.

For example, suppose the trade usage relevant to a contract is that a contract requiring the delivery of many boxes containing 20 items each is considered to be performed by the delivery of 19, 20 or 21 items in each box, perhaps because the fast pace of that particular business does not always allow such items to be precisely counted. In that situation, a court might say that a tender with 19 items in a particular box or boxes would be proper, that the buyer could not reject it, and that the buyer's duty to pay would become due.

Of course, this kind of discretion could be very dangerous. This is not so much because it will cause the buyer great harm--since it appears that the buyer will always have the protection of the substantial performance rule, even if the seller is not required to perform exactly as the contract seems to say. However, this discretion could be dangerous because it might create a risk that the court would not follow the intentions of the parties, or not follow the will of the legislature that enacted the statute. Courts must be very careful to follow such intentions and such legislation.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts"), Section 8.3h discussed the rule that courts examine surrounding circumstances such as course of performance, course of dealing and trade usages in order to interpret contracts.

Third Limit: The seller has the right to "cure" or fix the non-conforming tender under several circumstances. This is probably the most important limit on the rule about tenders under the UCC. It basically means that, under some circumstances, the seller who gave a non-conforming tender has the right to fix it for some period of time, and if he does fix it, then the buyer cannot reject it!



Specifically, the UCC says that a seller has the right to cure a non-conforming tender where:

(1) the time for performance (delivery) has not yet expired;

OR (2) the time for performance has expired, but the seller tells the buyer of his intention to cure within a reasonable time, and the seller reasonably thought that either:

(a) the non-conforming tender would be acceptable, or

(b) the non-conforming tender would be acceptable with a tender of money damages to "cure" the non-conformity.

Of course, if it is not possible to cure the tender within a reasonable time, then the tender cannot be cured. The ability of parties to other kinds of contracts to cure non-conforming performances will be discussed in Section 9.6b, below.

This rule about "cure" seems complex, but it basically means a seller has the right to cure in two situations. The first situation occurs where there is still time left before delivery is finally due. In that case, the seller can cure the non-conformity--by delivering the right quality and quantity of goods--any time up until the time for delivery in the contract. The seller has this right no matter how big his breach is.

The second situation occurs where the seller has made a non-conforming tender, but the seller had reason to believe his tender would be acceptable even though it was non-conforming. This might be because the seller included some extra money to compensate the buyer for the difference between the tender and what the contract said.

For example, suppose a contract requires the delivery of 50 chairs, and the seller delivers 40 with an appropriate amount of money to compensate the buyer for the breach, but the buyer rejects. A court might find that the seller reasonably thought the tender would be acceptable, and give the seller more time to cure it--even after the time for performance under the contract has expired.

Although the UCC will give the seller extra time to fix his tender where the seller thought money damages would make the non-conforming tender proper, it is not clear whether the UCC will allow the seller to actually cure using money damages! However, some authorities think the UCC should permit that, and should also permit sellers to cure by providing goods that are different but of equal value to those in the contract, since business persons commonly use such methods to cure non-conforming tenders.

Fourth Limit: The buyer's right to reject non-conforming tenders is subject to the duty of good faith under the UCC. This appears to mean that, although a buyer can generally reject even for a very small non-conformity in a tender, such a rejection must still be in good faith, or it will be

an improper rejection. Some authorities appear to say that a rejection is in good faith as long as the buyer is honestly dissatisfied with the tender. But if the buyer is really dissatisfied with the fact that he has made a bargain that is not favorable to him, and is merely using a tiny non-conformity in order to escape that bad bargain, that rejection is not in good faith! These rules are similar to some of the rules about conditions of disapproval, which were discussed in Section 9.4l, above. The duty of good faith in the performance of contracts will be further discussed in Section 9.5c, below.

For instance, in the tobacco sale example above, suppose the price of the tobacco became far lower than the contract price before the date of delivery. That would make the bargain a bad one for the buyer Sokvann, since he would have a contract duty to pay more than the current market price. Suppose also that Triv delivered one kilogram less than the 100 tons of tobacco the contract required, and Sokvann rejected that tender. In that case, courts would look very closely to see if Sokvann was really dissatisfied with the tender--or if he rejected because he wanted to escape his bad bargain! If the rejection was in bad faith, it appears that the rejection would be improper, and Sokvann's duty to pay would become due despite the small non-conformity.

Fifth Limit: There are technical limits on a buyer's ability to reject, or to revoke his acceptance of goods. If these limits are violated, the buyer may be required to accept the non-conforming tender. The UCC says that rejection must occur within a reasonable time after the tender, and the buyer must notify the seller about the rejection within a reasonable time, or else the rejection is not proper. In addition, rejection cannot occur after a buyer has "accepted" the goods. Very generally, a buyer may be considered to have accepted goods under the UCC if: the buyer indicates to the seller that the goods are acceptable after having a reasonable chance to inspect them; the buyer fails to reject within a reasonable time; or the buyer basically does something inconsistent with the seller's ownership, such as using the goods. If the buyer does accept goods that are non-conforming, she may recover the difference between the actual value of the goods she accepted and the value the goods would have had if they were conforming. This is further discussed in Chapter 10 ("Remedies"), Section 10.8a.

A buyer may "revoke" his acceptance of goods, but only in limited circumstances. A proper revocation of acceptance has the same effect as a proper rejection--the buyer's duty to pay does not become due, and he may seek a remedy to compensate for the seller's breach. But there are many requirements for a proper revocation, and the result of these would seem to be that it is difficult to make one. One requirement is that a buyer can revoke only if the non-conformity makes the goods substantially less valuable to the buyer. Another requirement is that such a revocation must occur within a reasonable time after the buyer knew or should have known of the reason for it. In addition, the revocation must occur before any substantial change in the condition of the goods which is not caused by the goods' own defects.

And the revocation is not effective until the buyer notifies the seller about it. Another requirement is that the buyer can revoke only where:

(1) the buyer accepted because of his reasonable assumption that the non-conformity would be cured, and it has not been cured; or

(2) the buyer accepted without discovering the non-conformity, and this was reasonably caused by the difficulty of discovering it or by assurances by the seller.

Since every revocation of acceptance must meet all these requirements, it would appear to be difficult to make a proper revocation once a buyer has accepted goods.

*** ***WHY IS THIS IMPORTANT?*** Why does the UCC apply the above rules where there is some problem with the tender of goods in a single lot contract?

The general rule described above is that a buyer can reject a tender of goods in a single lot contract because of any non-conformity to the contract, no matter how small. This rule gives tremendous power to buyers in sale of goods contracts. If the rule was strictly applied, it might cause effects similar to express conditions, although it probably would not cause many forfeitures, since the seller could generally get his goods back following a rejection.

The reason for the rule may be to give buyers extra protection from having to accept something they do not want. Perhaps some buyers find it difficult to reject once a seller has already delivered, or difficult to seek a legal remedy every time a tender of goods is not perfect. It may also be that the law wishes to motivate sellers to be careful about filling orders for goods, and about delivering the goods in good condition.

But the many limits on the rule may often result in the rule having little effect, and in courts actually applying the substantial performance rule explained in Section 9.4c, above. These limits may show that the law is not happy with the harshness of its own rule, and that it wants to reduce that harshness in a number of situations where it could be unfair to sellers. In particular, the law appears to use the limits to reduce the ability of buyers to abuse their power, perhaps by using it to escape bad bargains, or to set unreasonable standards for tenders of goods. However, it is not clear whether trying to apply all the complex limits noted above is better than simply changing the general rule to something closer to the substantial performance rule.

*** ***CASE STUDY 214*** **(U.S. commercial code)**

FACTS Sna agrees to buy a model A-100 flashlight from Pochin for a certain price. On the day before delivery is due, Pochin delivers to Sna a new model A-200 flashlight, which is actually a "new and improved" version of

the A-100. Pochin is happy to provide Sna with this new product, which he thinks is at least as good as the A-100 model.

However, Sna rejects the A-200 flashlight, and says he is terminating the contract. Pochin is unable to persuade Sna to accept the A-200--or even to accept one of the A-100 models! Sna says his rejection is permanent, and that there is nothing Pochin can do to continue under the contract. Pochin asks his attorney about his options.

QUESTION OF LAW Is there anything Pochin can do to continue under the contract despite Sna's rejection of the flashlight?

DECISION Yes. Pochin can cure his non-conforming tender by delivering an A-100 flashlight before the time for delivery expires--and probably even for a reasonable time after the time for delivery expires, if he notifies Sna about what he is doing.

In general, the UCC says a buyer may reject any non-conforming tender in a single lot contract, no matter how small the non-conformity. However, one of the many limits on this general rule is that a seller may cure his non-conforming tender by making a proper tender before the time for performance expires. In addition, if the seller reasonably thought the non-conforming tender would be acceptable to the buyer, the seller may notify the buyer and cure within a reasonable time even after the time for performance has expired.

In this case, Pochin did not deliver the A-100 flashlight the contract required, and Sna rejected it. However, Pochin did make the delivery one day before performance was due. So if Pochin still had time left under the contract, he could cure the tender, and Sna would be required to accept it. In addition, Pochin has another option, because he reasonably thought that the "new and improved" A-200 flashlight would be acceptable to Sna. Pochin's idea was reasonable because people often (though not always) like new and improved models of products at least as well as the old models. In this situation, if Pochin notifies Sna and delivers an A-100 flashlight within a reasonable time--even if that is after the time for performance under the contract expires--he will cure the tender.

(c) The rights of parties to installment contracts -- In installment contracts, the general rule is that the buyer can reject a non-conforming tender of an installment only if the non-conformity substantially reduces the value of the installment and it cannot be cured. Obviously, this rule is much different from the rule about single lot contracts. In fact, this rule is more favorable to sellers, because it appears to take an approach that is similar to the substantial performance rule discussed in Section 9.4c above. In other words, the buyer's duty to pay for the installment will probably become due as long as the non-conforming tender is not a serious breach of the contract.

The reason the UCC has a more favorable rule for sellers in installment contracts may be that it believes that defects in one installment of such contracts are less likely to cause substantial problems for the whole contract. The UCC may also want to make sure that a non-conformity really is serious before allowing it to threaten an installment contract, since such contracts are often large, long-term arrangements that should not be allowed to fail because of small problems. The rules about installment contracts are explained in more detail below.

Where one installment of an installment contract is a non-conforming tender, there are basically four possible situations:

(1) the non-conformity does not substantially reduce the value of the installment;

(2) the non-conformity substantially reduces the value of the installment but the problem can be cured;

(3) the non-conformity substantially reduces the value of the installment and the problem cannot be cured; or

(4) the non-conformity is so serious that it substantially reduces the value of the whole contract and it cannot be cured.

Each of these situations is briefly discussed below.

First, if the non-conformity does not substantially reduce the value of the installment, the buyer must accept it and continue with the contract. This is similar to the substantial performance rule discussed in Section 9.4c. In other words, it appears that "substantially reduces the value" means something similar to "is a material breach." Factors that might be relevant to whether a non-conformity substantially reduces the value include the quality and quantity of the goods, and the time of delivery. Obviously this rule is much better for sellers than the general "single lot" rule discussed above, under which any non-conformity would give a buyer the right to reject the tender and end the contract. For example, it seems unlikely that the delivery of the "new and improved" flashlight in Case Study 214 could be rejected if it was an installment in an installment contract, since it is unlikely that it would substantially reduce the value of that installment. Of course, even though a buyer must accept non-conforming tenders that do not substantially reduce the value of the installment, the buyer may still seek a remedy for the seller's breach in failing to follow the contract.

Second, if the non-conformity substantially reduces the value of the installment but the problem can be cured, and the seller cures or provides an adequate assurance that he will cure, then the buyer must accept the installment. If a non-conformity in the delivery of an installment does substantially reduce the value of the installment, but the problem can be cured by the seller, then it appears that the buyer cannot reject until it is clear that a cure will not occur. If the seller cures or gives an adequate assurance that

he will cure a non-conforming installment, the buyer must accept the installment. Of course, even if the seller cures, and the buyer's duty to pay becomes due, the buyer still has the right to recover any damages he suffered because of the non-conforming tender.

The UCC says that the buyer must accept an installment if the seller gives an "adequate assurance" that he will cure. Whether such an assurance is adequate under the UCC depends on the same factors that were discussed in Section 9.4e above, which explained prospective inability or unwillingness to perform. In other words, it appears that it must be an assurance that a party could reasonably believe. This situation is similar to the one where a party has reason to believe that the other party will not be able or willing to perform. In fact, a non-conforming installment could actually provide such a reason with respect to the rest of the contract! Section 9.4e discussed prospective inability or unwillingness to perform.

Of course, if the buyer accepts the goods in this situation but the seller fails to cure the problem, then the buyer may revoke his acceptance of the goods. Likewise, if the seller fails to give an adequate assurance that he will cure, the buyer may reject the installment. However, even if a buyer properly rejects an installment, that does not necessarily mean he has the right to end the whole contract! This will be discussed further below.

For example, if a restaurant made a contract to buy rice, to be delivered in installments of 200 kilos per month for one year, that would be an installment contract. If one delivery contained only 130 kilos, that non-conformity might substantially reduce the value of the installment. But if the non-conformity could be cured, as it probably could through the prompt delivery of 70 more kilos of rice, and the seller gave an adequate assurance of cure, then the restaurant would have to accept the delivery of the 130 kilos. If the rice seller gave the restaurant that assurance--perhaps by giving a believable assurance that this was just an error and that he would soon deliver 70 kilos from the tons of rice at his warehouse--then the restaurant would have to accept the installment. Of course, if the rice seller failed to cure, the restaurant could revoke its acceptance.

Third, if a non-conformity substantially reduces the value of the installment and the problem cannot be cured, the buyer may reject the installment. Where the non-conformity substantially impairs the value of the installment and it cannot be cured, the buyer may reject the installment right away. However, as will be discussed below, that does not mean the buyer can end the whole contract.

It is not exactly clear what kind of non-conformity in a sale of goods delivery "cannot be cured." It would seem possible to replace or deliver more of most kinds of goods within a reasonable time. However, it may be that some goods are so rare, unique, difficult to make, or difficult to transport that a non-conforming tender could not be cured, at least in some cases.

For example, suppose a government and an airplane manufacturer made a contract for the manufacturer to deliver 30 new jet fighter planes, in three lots of 10 planes each over the next three years, and that one installment actually contained only six planes. In that case, it seems possible that the non-conformity could not be cured within a reasonable time, since four more planes might be impossible to manufacture and deliver within a reasonable time.

Fourth, if a non-conformity substantially reduces the value of the whole contract, the buyer may reject the installment, end the contract and ask a court for a remedy. It is possible for a non-conformity in an installment to be so serious that it substantially reduces the value of the whole contract. When that occurs, and cure is not possible, the effect under the UCC appears to be like a material breach--the buyer may end the contract and ask a court for a remedy like money damages. However, it would seem that a non-conformity in a particular installment would have to be very serious to substantially reduce the value of the whole contract. For instance, in the rice example above, it seems unlikely that a shortage of 70 kilos of rice in one installment would substantially reduce the value of the 2400 kilos of rice in the whole contract. However, suppose a manufacturer agreed to deliver the various parts of one large, specially manufactured machine in a number of installments. If one of these installments had a very serious problem that could not be cured--such as if an essential part was delivered in a broken state, there was no way it could be cured, and the whole machine could not work without the part--then the buyer would have the right to end the contract and ask a court for a remedy.

However, even when the value of an installment contract is substantially reduced, the UCC says that several particular actions by a buyer may actually have the effect of reinstating the contract. These actions will apparently cause the buyer to lose (or waive) his right to end the contract. This can occur in situations where the buyer:

(a) accepts the non-conforming installment and fails to notify the seller that he is canceling the contract within a reasonable time;

(b) asks a court for remedies only for problems with past installments;

or (c) asks the seller to provide future installments.

So even where a non-conformity substantially reduces the value of the whole contract, the buyer must be careful to preserve his rights if he wishes to end the contract.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies"), Section 10.8a contains further discussion of remedies that may be available to parties where there is a performance problem with a sale of goods contract.

9.5c The Duty of Good Faith and Fair Dealing Applies to Contract Performance in Many Jurisdictions

Many jurisdictions say that the duty of good faith and fair dealing is present in every contract. This duty can be important in the performance of contracts. The duty has already been discussed in some detail in other parts of this text, especially in Chapter 8 ("Interpretation of Contracts"), Section 8.3j. The general result of a breach of this duty would appear to be that the party harmed would be entitled to a remedy to compensate him for any damage caused.

*** **DEFINITION:** The **duty of good faith and fair dealing** basically requires a party to a contract to be honest and not seek unfair advantage over the other party (good faith), and to follow reasonable standards of fair conduct in the particular type of contract the parties made (fair dealing).

As discussed in Chapter 8, many jurisdictions say this duty applies to the performance and enforcement of contracts. In many civil law jurisdictions, such as France and Germany, the duty also applies during the negotiation stage of contracts. But in many common law jurisdictions, the duty does not generally apply at that stage.

In all jurisdictions, courts are careful to apply the duty of good faith and fair dealing only in situations where it is clear that the parties have not respected the contract. The reason is that the duty is very difficult to define, and the law does not want courts to use it too widely, or it might cause serious harm to the other rules about the performance and enforcement of contracts. Courts do not define the duty of good faith and fair dealing in a way that harms other legal rules. In fact, the duty is generally used to supplement or help define other rules, as explained below.

Unfortunately, authorities do not appear to agree about exactly what violates the duty of good faith and fair dealing. And as explained in Chapter 8, the rules about the duty of good faith and fair dealing do not always apply the same way in different situations. In some situations, courts may apply only the "good faith" standard, and not any duty of "fair dealing." For example, the Uniform Commercial Code in the United States seems to apply only a "good faith" requirement to sale of goods contracts generally, but to apply that requirement and a "fair dealing" requirement to merchants involved in such contracts. In any case, it is important to check the local law about this uncertain area.



Some examples of conduct which some authorities say violates the duty of good faith and fair dealing in the performance of contracts are:

(1) a lack of diligence in performing a contract;

(2) intentionally giving an imperfect performance of a contract;

(3) interfering with the other party's ability to benefit from the contract;

or (4) interfering with the other party's performance.

Chapter 8 gave several examples of cases where these kinds of violations might occur. One was the situation where an insurance company denied coverage of a party's claim under a policy, even though the insurance company knew the claim really was covered. That forced the party to bring a lawsuit about the insurance coverage to court, and perhaps suffer other damage.

Another example was Case Study 188, in which parties to two nightclub singing contracts took a number of actions that may have violated the duty of good faith and fair dealing. These actions included interfering with the performance of other parties under the contract (tampering with a singer's sound system); intentionally giving an imperfect performance (intentionally singing badly); and preventing another party to the contract from receiving the benefits of the contract (doing either of the above things).

The duty of good faith and fair dealing also appears to be used as a way to help define or explain other legal rules about performance in a number of situations discussed in this Chapter. That is, the duty may be a way to help measure whether conditions are fulfilled or excused, or whether promises are performed or breached. In particular, it appears that certain violations of the duty of good faith and fair dealing may actually excuse conditions, because they may be basically the same as certain excuses explained in Section 9.4 above. So the duty may actually help courts analyze the performance of the rest of the contract.

One situation where the duty of good faith and fair dealing might apply is where there are conditions of approval. As discussed in Section 9.4l above, the law says there are certain limits on the ability of parties and non-parties to cause such conditions to fail by disapproving performances under the contract. If these limits are not followed, the condition will be excused, and the duty that depended on the condition will become due for performance. Some of these limits could also be defined by the duty of good faith and fair dealing. That is, some courts might say that when a party does not follow those limits, he is violating the duty of good faith and fair dealing in performing the contract. For example, where a party or a "special" non-party evaluates a matter of aesthetics, such as in the painting examples in Section 9.4l, courts in many jurisdictions say that the condition will fail only if the disapproving party is honestly dissatisfied with the performance. But since this "honesty"

is very similar to the duty of good faith, this rule could also be explained by saying that the condition of approval will fail in these situations only if the disapproving party follows the duty of good faith in evaluating the performance! And unreasonable disapprovals of performances related to practical matters might also be described as violations of the duty of fair dealing. This is because such disapprovals might not follow reasonable standards of fair conduct in the relevant trade. So this might be a different way for courts to achieve the same result in this kind of situation.

Another situation where the duty of good faith and fair dealing may apply is where one party wrongly prevents or hinders the occurrence of a condition in the contract. As explained in Section 9.4h above, where a party wrongly prevents or hinders the occurrence of a condition, the condition is excused, and the duty that depended on that condition becomes due. This kind of problem could also be defined by the duty of good faith and fair dealing. The reason is that this kind of wrongful behavior might also be considered an attempt to seek unfair advantage in the performance of the contract, and a failure to follow reasonable standards of fair conduct in the trade.

For example, in Case Study 207, the actions of the De-mining Foundation in wrongly preventing the Special Company from fulfilling the condition of delivering the special goods by a certain date--and then claiming that the Special Company had failed to fulfill the condition--could also be described as a violation of the duty of good faith and fair dealing. That is because these actions might be considered an attempt to seek unfair advantage and a failure to follow reasonable standards of fair conduct.

Another situation where the duty of good faith and fair dealing is relevant is where there is a rejection of a tender of performance. As explained in Section 9.4g, an improper rejection of a tender of performance will excuse conditions, and cause the duties that depend on those conditions to become due for performance. Such improper rejections could be considered violations of the duty of good faith and fair dealing, for reasons similar to those described above about wrongful prevention or hindrance. For example, in Case Study 206, Souley's rejection of Vannay's tender of the money for the tractor could be considered a violation of the duty of good faith and fair dealing. In addition, under the Uniform Commercial Code in the United States, a buyer in a single lot contract may not reject a tender of goods for a minor reason if that rejection is not in good faith. Good faith appears to generally mean that the buyer is honestly dissatisfied with the tender--rather than dissatisfied with his bargain. This is true even though the UCC generally allows buyers in such contracts to reject goods for any non-conformity.

Finally, the duty of good faith and fair dealing may be relevant in difficult situations such as those involving construction contracts, which were discussed in Section 9.5a above. As explained above, courts sometimes struggle with what to do when a builder in such a contract performs with only a minor defect, but the contract contains an express condition, so that a great

forfeiture may result if the condition fails. In that situation, some courts appear to apply new rules in order to avoid a forfeiture, and find that the land owner's duty to pay has become due. One way to analyze that situation might be to say that the land owner has actually violated the duty of good faith and fair dealing by withholding his performance (paying for the construction) on the basis of the failure of the express condition where it was so likely to cause a forfeiture. The land owner's acts in the situation might be an attempt to seek unfair advantage, or a failure to follow reasonable standards of fair conduct in the construction business. For example, this might be a different way to explain the result in Case Study 213. In that case, the land owner Mareth might not be permitted to withhold his payment for the construction of the house that Bun Ly had completed according to the contract--except for having built the house three feet away from where the contract required.

Many jurisdictions say that, in certain special situations, to breach a contract in violation of the duty of good faith and fair dealing--in "bad faith"--is actually a tort. This was already discussed in Chapter 8 ("Interpretation of Contracts"), Section 8.3j. Most courts have been careful to limit this tort to certain types of cases. These seem to be where:

(1) there is some special relationship between the parties to the contract that involves elements such as the public interest and adhesion;

or (2) a party's conduct in breaching is notably malicious, oppressive, unreasonable, or unjustifiable.

An important area in which courts have found this to occur is in insurance contracts, where an insurance company refuses in bad faith to pay a claim submitted by one of its policyholders. Another situation where some courts have found the tort of bad faith to exist is where a party denies without any legitimate reason that a contract even exists. In situations like these, punitive damages may be available, though that is unusual in contract disputes. This will be discussed in more detail in Chapter 10 ("Remedies"), Section 10.5d.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.4a discusses the duty of good faith and fair dealing in the context of misrepresentation in the inducement; Chapter 8 ("Interpretation of Contracts"), Section 8.3j discusses the duty of good faith and fair dealing in some detail; and Chapter 10 ("Remedies"), Section 10.5d discusses how a bad faith breach of contract can be a tort in limited situations.

9.6 Performance, Breach, or Other Events Related Directly to the Performance of the Contract May Discharge Contract Duties

Once a court has decided that a contract duty is due for performance--and sometimes even when the duty is not yet due for performance--the court must decide whether that duty has been discharged, or the duty is or

will be still due for performance. If the duty has been discharged, then the party with that duty will not be obligated to perform it. This could occur because the party already performed the duty, or for many other reasons, as will be explained in Sections 9.6-9.8 of this Chapter. If the duty is still due for performance, then the court may choose to order one of the remedies discussed in Chapter 10 ("Remedies").

Contract duties may be discharged in ways that relate closely to the performance of the contract itself. In fact, contract duties may be discharged by performance, breach, or certain other events related directly to the performance of the contract. This Section will explore these ways that contract duties may be discharged. Specifically, the Section will discuss six situations where contract duties may be discharged:

(1) complete performance discharges the contract duties of the performing party (Section 9.6a);

(2) a breach may discharge the contract duties of the innocent party (Section 9.6b);

(3) an anticipatory repudiation may discharge the contract duties of the innocent party (Section 9.6c);

(4) an improper rejection of a tender of performance may discharge the contract duties of the innocent party (Section 9.6d);

(5) the occurrence of a condition subsequent may discharge contract duties (Section 9.6e); and

(6) the avoidance of contract duties in a voidable contract may discharge contract duties (Section 9.6f).

9.6a Complete Performance Discharges the Contract Duties of the Performing Party

Complete performance by all parties is the goal of every contract, and it is the ideal way for a contract to end. This may be easy to forget while studying the rules about how the law deals with contracts that are not completely performed, or that have some other problem. Most contracts end with complete performance by all parties--and the parties are happy to have no dispute about performance or other legal problems!

When one party provides complete performance of his contract duties, those duties are discharged. That means the party basically has no other duties to perform under the contract. Of course, the party may still have obligations not to interfere with the other party's performance or benefits under the contract, or otherwise violate the duty of good faith and fair dealing, as discussed in Section 9.5c above. But complete performance generally means the party who performed is finished with the contract.

Complete performance as a way to fulfill conditions was already discussed in Section 9.4b, above. For example, in Case Study 200, when the Rubber Company delivered all the rubber required by its contract with the Tire Company, the Rubber Company had completely performed. In addition to fulfilling the condition concurrent to the Tire Company's duty to pay for the rubber, the Rubber Company's delivery discharged its own duties under the contract. In other words, the Rubber Company had nothing left to do under the contract. Case Study 200 is also an example of how one party's duties may be discharged, even though another party's duties are not discharged. In that case, the Rubber Company's duties were discharged, but the Tire Company's duties were not yet discharged. The following Case Study is another example of the effects of complete performance.

*** ***CASE STUDY 215***

FACTS Vichit and Ry agreed that Ry would rent Vichit's car for one week, and that Ry would pay Vichit 50,000 riels right after Ry returned the car. Ry used the car for one week, and then returned it. Immediately after Ry returned the car, she paid Vichit 50,000 riels. The parties thanked each other for doing such a good job performing the contract. Then they went out to celebrate the fact that they had had no problems in performing the contract.

QUESTION OF LAW Are the duties of the parties to this contract discharged?

DECISION Yes. The duties of both Vichit and Ry have been discharged because both parties have completely performed those duties under the contract.

When a party completely performs a contract duty, that duty is discharged. So that party basically has no further obligation under the contract.

In this case, both Ry and Vichit completely performed their duties under the contract. Vichit had a duty to rent his car to Ry for one week. When that duty was completely performed--when Ry had had use of the car for one week--Vichit's duty under the contract was discharged. Ry had a duty to pay Vichit 50,000 riels. When that duty was completely performed--when Ry paid Vichit the full amount of money--Ry's duty under the contract was discharged. So both parties completely performed, and all duties in this contract were discharged. In fact, the contract is executed, since it has been fully performed by all parties.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3c contains further discussion of executed contracts.

Sometimes a performance looks complete, but in reality it is not. For example, suppose the 50,000 riels Ry paid in Case Study 215 turned out

to be counterfeit. In that case, Ry's performance would not have been complete, even though it may have looked complete, and even though Vichit may not have discovered the problem for some time. In fact, that would be a material breach of the contract, and Vichit would have the right to ask a court for a remedy because of Ry's failure to perform her duties. Another example might be where a builder builds a house under a contract. The house may look "complete," but if the house has not been built exactly according to the contract, the performance is not complete. So it is important to make sure that a party really has performed completely according to the contract, because that is what is required in order for that party's duties to be discharged.

It appears that substantial performance--which is less than complete--does not discharge the duty of the party who performed. This is because that party still has a duty to perform the minor part of the contract that he has failed to perform. He is not finished, so his duty has not ended. So even though a party who substantially performs has done enough to fulfill an implied-in-law condition, and cause the other party's duty to become due for performance, the party's own duty is not discharged. It appears that this duty may be finally discharged in several ways. First, in some cases it may be possible for the party to cure his breach and provide complete performance, as discussed in Section 9.5b, above, and as will be further discussed in Section 9.6b, below. In addition, if the innocent party asks a court for a remedy for the breach, and the court finally resolves the case and issues a final judgment about it, that will discharge the duties of the parties, as discussed in Section 9.8d below. And the duty may be discharged in other ways that will be explained in Sections 9.7 and 9.8.

9.6b A Breach May Discharge the Contract Duties of the Innocent Party

Another important way contract duties are discharged is by a breach of the contract. In certain situations, a breach of the contract by one party will discharge the contract duties of the other party to a contract.

In general, a breach may lead to the discharge of the duties of the non-breaching party where that breach causes a condition to fail--and therefore prevents the duty of the non-breaching party from becoming due for performance. In particular, this can occur if there is a material breach that causes an implied-in-law condition to fail, any breach that causes an express or implied-in-fact condition to fail, or any breach that causes a condition to fail because of a special statute. In other words, where a condition precedent to a duty is not fulfilled or excused, that duty will not become due, and that duty will often be discharged.

However, not every breach that causes a condition to fail necessarily discharges the duties of the non-breaching party. One reason is that the non-breaching party may choose not to treat the non-conforming performance as a breach. That generally results in a waiver of the non-breaching party's right

to insist that a condition occur before his own duty is due. Or the breaching party may be able to cure the breach, and cause the non-breaching party's duty to become due in that way.

As noted above, any breach that causes a duty not to become due may discharge duties. The most common way this occurs is where there is a material breach, and that situation will be the basis for our discussion below. However, the rules explained below would appear to be similar for other breaches that cause conditions to fail, including breaches that cause express and implied-in-fact conditions to fail, and also breaches that cause conditions to fail under special statutes, such as the Uniform Commercial Code in the United States. Obviously, these breaches need not be material in order to cause conditions to fail.

For example, the general rule under the Uniform Commercial Code is that any non-conformity in a tender in a single lot contract allows the buyer to reject, as explained in Section 9.5b. Of course, such a non-conformity would be a breach. A buyer's rejection in that situation would discharge the buyer's duties, unless it was affected by one of the limits discussed in Section 9.5b.

When one party fails to substantially perform--committing a material breach--the other party basically has three choices:

(1) declare a material breach of the contract, end the contract, and cause his own duties to be discharged;

(2) unilaterally rescind the contract, ending the contract, and causing all duties under the contract to be discharged;

OR (3) choose to continue with the contract, which would generally result in a waiver of the right to insist that the condition occur before the waiving party's duty becomes due.

These options are discussed in more detail below.

First Option -- If the non-breaching party chooses the first option, he basically says the contract is over because the breaching party failed to perform it. The effect of this is to discharge the duties of the non-breaching party. Of course, the duties of the breaching party are not discharged, and the non-breaching party can (and often does) ask a court for a remedy to compensate him for the breach.

For example, suppose a seller materially breaches a contract for the sale of umbrellas by delivering only half the umbrellas required. In that case, the buyer would have the right to reject the umbrellas, declare a material breach, end the contract, and cause his own duty to pay to be discharged. Of course, the seller's duty would not be discharged, and the buyer could ask for a remedy to compensate him for the breach.

Second Option -- The non-breaching party may also choose the second option, and unilaterally rescind the contract. The idea of rescission was already introduced in Chapter 3 ("Consideration"), Section 3.7a. Rescission basically means canceling the contract. Like the first option above, rescission basically ends the contract. But the big difference is that rescission discharges all duties under the contract--including those of the breaching party! This would appear to prevent the non-breaching party from asking a court for a remedy for the breach of the contract, since the breaching party would have no duty left under the contract. So non-breaching parties must be careful not to unilaterally rescind contracts unless they are ready to give up the right to ask for such a remedy.

Of course, if there was a rescission, either party could still ask a court for restitution of what he had given to the other party under such a contract. For instance, in the umbrella example above, the buyer could choose to unilaterally rescind the contract after the seller's breach. This would end the contract and discharge all duties--including the seller's duties. In that situation, it appears that the buyer would not be able to ask a court for a remedy for the seller's breach of the contract. So the court would not order the seller to actually perform, or to pay the buyer money damages he might have suffered as a result of the breach, such as lost profits. But either party could ask for restitution of what he had given to the other party. Rescission will be further discussed in Section 9.7a below, and in Chapter 10 ("Remedies"), Section 10.7b.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7a discussed rescission as an exception to the general rule that modifications of contracts require consideration in common law jurisdictions; and Chapter 10 ("Remedies"), Section 10.4 discusses restitution, and Section 10.7b discusses rescission.

Third Option -- If the non-breaching party chooses the third option, and continues under the contract, it generally means the party is waiving his right to insist that the condition occur before his duty becomes due. Of course, as discussed in Section 9.4i above, such a waiver does not generally affect the non-breaching party's right to ask a court for a remedy for the breach, unless there is also a binding modification of the contract. But such a waiver would also mean that the non-breaching party's duties were not discharged. In other words, the non-breaching party would still have a duty to perform. For instance, in the umbrella example above, the buyer might choose to waive his right to receive complete performance before his duty to pay would become due. In that case, his duty to pay would not be discharged until he paid. Of course, he would have the right to a remedy for damage he suffered because of the seller's breach. Special rules might affect when a waiver might occur, such as the rules about waiver in sale of goods contracts which were discussed in Sections 9.5a and 9.5b, above. Section 9.4i discussed waiver as a way conditions might be excused.

Another way in which a breach would not cause the duties of the non-breaching party to be discharged is if the breaching party "cures" or fixes the breach. The breaching party's ability to cure under special statutes about sale of goods contracts was already discussed in Section 9.5b, above. It appears that the general rule that applies to all kinds of contracts in many jurisdictions is that a breaching party may cure his breach if he can fix the problem within a reasonable or appropriate time. This would appear to mean the cure might even occur after the date for performance, if that was within a reasonable or appropriate time, unless there was an express or implied-in-fact condition that performance occur no later than that date. Where such a breach can be cured, many jurisdictions say that the duty of the non-breaching party is suspended until the breaching party has had a reasonable opportunity to cure. If the cure occurs within a reasonable time, the non-breaching party's duty is not discharged. If the cure does not occur within a reasonable time, then the non-breaching party's duty is discharged. These ideas are discussed in more detail below.

When there is a material breach, there are basically three possible situations with respect to cure by the breaching party:

(1) the breach cannot be cured;

(2) the breach can be cured but the breaching party fails to do so within a reasonable time;

(3) the breach can be cured, and is cured within a reasonable time.

Some material breaches cannot be cured. Such breaches cause conditions to fail, and duties of the non-breaching party to be discharged. An example would be the sale of goods contract for the specially manufactured machine, discussed in Section 9.5b above, in which a crucial part of the machine was delivered in a defective state. In that situation, the seller could not possibly cure the delivery of the defective part within a reasonable time. So the duties of the buyer would be discharged.

Sometimes the material breach can be cured but the breaching party fails to do so within a reasonable time. In that situation, the breach will only suspend the duty of the non-breaching party while cure is still possible. But once cure is no longer possible, the breach will cause the condition to fail, and the duties of the non-breaching party will be discharged. For example, in the umbrella example above, it would seem fairly easy to cure the breach by delivering the rest of the umbrellas required by the contract. But if the seller failed to do that within a reasonable time, the duty of the buyer to pay would be discharged.

Finally, sometimes a material breach can be cured and is cured within a reasonable time. In that situation, the breach suspends the duty of the non-breaching party until the cure occurs. When the cure occurs, the performance is complete (or at least substantial), and it causes the duty of the

non-breaching party to become due for performance. So in that case, the breach does not discharge the duty of the non-breaching party. For instance, in the umbrella example, if the seller delivered the other umbrellas required by the contract within a reasonable time, then the seller's performance would be complete, and the buyer's duty would become due. The buyer's duty would not be discharged by the seller's breach.

One difficult question about cure of a breach is how much time is needed to give a breaching party a reasonable opportunity to cure. This will vary according to the circumstances of each case. Some factors that some jurisdictions say are important in deciding how much time the breaching party should have to cure are:

(1) how much a delay in the performance harms the non-breaching party;

(2) how much risk of forfeiture the breaching party faces if the other party declares a material breach;

(3) how likely it is that the breaching party will cure;

(4) the subject matter of the contract;

and (5) anything the contract itself says about the time for performance.

The factors above will influence how much time a breaching party has to cure. The more harm a delay in performance will cause the innocent party, the less time the breaching party will have to cure. On the other hand, the greater risk of forfeiture to the breaching party, the more time that party is likely to have to cure! For example, a builder might be given more time to cure because of the great risk of forfeiture in many construction contracts. In addition, the more likely it is that a breaching party will cure, the more time that party is likely to get to cure. For example, if a party gives adequate assurances of cure, the party is likely to get more time than if the party says nothing. Of course, if a party refuses to cure, or if cure is impossible within a reasonable time, the breaching party will get no time to cure, and the non-breaching party may declare a material breach immediately. A refusal to cure a material breach might be similar to an anticipatory repudiation, which will be discussed in Section 9.6c, below. Parties who breach some types of contracts may receive more time to cure. It appears that parties who breach sale of goods contracts generally receive less time to cure than parties to land sale or service contracts, since time is more likely to be important in sale of goods contracts. Finally, if the contract itself discusses the time for performance--such as if it says that "time is of the essence"--that will affect how much time a breaching party will have to cure.

Breaches that result in a discharge of duties may take forms other than a simple failure to perform completely when performance is scheduled to occur under the contract. For example, an anticipatory repudiation may result in a breach that discharges the non-repudiating party's duties, as will be explained

in Section 9.6c. In addition, it appears that some of the other events that may excuse conditions might also result in discharge of duties. For example, if a party prevents or hinders another party from performing, that would excuse any condition that consisted of the performance. But it might also be a breach of the contract that would discharge the duty of the other party to perform, if the breaching party prevented the other's performance in a way that meant the other party could not perform at all. It might be considered a breach of an implied promise to cooperate, or the duty of good faith and fair dealing. Excuse of conditions because of wrongful prevention or hindrance was discussed in Section 9.4h, and the duty of good faith and fair dealing was discussed in Section 9.5c.

Even if the duties of a party are discharged because of a breach, either party can generally ask a court for restitution of what he has provided to the other party under the contract, under the doctrine of quasi-contract. Of course, the breaching party will only be able to recover if he can show that there has been unjust enrichment. His recovery will be reduced by the damage he has caused the other party. And there are other limits on what he can recover. This is discussed in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5c, and Chapter 10 ("Remedies"), Section 10.4a.

******* ***CASE STUDY 216***

FACTS Samean agreed to build a new addition onto Niam's house for a certain price. Samean worked on the house for several months. Finally, he told Niam that he was finished, and he asked for the money for the construction work.

The addition looked all right from the outside, but unfortunately, there were many problems with Samean's work. The walls had many large holes, the plumbing and electric did not work, and many of the doors and windows were missing or did not fit correctly. The roof leaked badly. Niam told Samean that he had done a lousy job, and she refused to pay him until he fixed the problems. Samean promised to fix the problems, but when his workers came back, they spent most of their time talking and smoking cigarettes. They only patched a few of the holes in the walls. Then they went away and never came back.

Several weeks after the workers left, Samean came and asked Niam for the money for the construction. Niam said Samean had not fixed most of the problems, and she refused to pay him. Samean asked the court for help.

QUESTION OF LAW Is Niam's duty to pay for the work discharged?

DECISION Yes. Niam's duty to pay Samean for the construction work is discharged because of Samean's material breach of the contract.

A breach of a contract that causes a condition to fail, such as a material breach, may discharge the duty that depended on that condition--the duty of the non-breaching party. In this case, Samean made a contract to build an addition onto Niam's house. But the work he did had many problems, and it seems clear that he did not substantially perform--that his performance was a material breach.

However, although this material breach suspended Niam's duty to pay, it did not discharge it, because Samean could have cured the breach within a reasonable time. Unfortunately, Samean failed to do that, because his workers fixed only a few of the holes in the walls, then went away and never came back. A builder in Samean's situation might receive a substantial amount of time to cure, because of the risk to forfeiture to him, and also because he said he would cure. However, Samean has failed to cure his breach, despite being given a substantial amount of time to do so. And there is no indication that he plans to do any more work. So Niam is justified in declaring a material breach and ending the contract. Niam's duty to pay for the work is discharged, and Niam could also ask the court for a remedy to compensate her for Samean's breach.

Of course, Samean could ask the court for restitution of the reasonable value of the work that he provided to Niam. But it is not clear how much unjust enrichment there was here. This might depend in part on how much money and time it would cost Niam to fix the problems with the work that Samean did.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5c, and Chapter 10 ("Remedies"), Section 10.4a discuss the possibility that a breaching party can recover restitution under the doctrine of quasi-contract.

9.6c An Anticipatory Repudiation May Discharge the Contract Duties of the Innocent Party

An anticipatory repudiation is basically a statement by a party that clearly shows that party does not intend to perform a contract duty when that performance is due. Anticipatory repudiation was already explained in some detail in Section 9.4d of this Chapter. As explained earlier, when an anticipatory repudiation occurs, it excuses any conditions on which the repudiating party's duty depends. So that duty will become due for performance, even though the condition has not been fulfilled.

But another important effect discussed in Section 9.4d is that an anticipatory repudiation generally gives the other party the right to treat the repudiation as a material breach and immediately ask a court for a remedy, among other options. If the non-repudiating party decides to treat the repudiation as a breach, then the non-repudiating party's duties under the contract will be discharged in the same way as with other material breaches,

as discussed in Section 9.6b, above. Another option the non-repudiating party has is to unilaterally rescind the contract. This would result in the discharge of all the duties in the contract, as also discussed in Section 9.6b. Of course, it is also possible for a repudiating party to retract a repudiation, unless the non-repudiating party has accepted or detrimentally relied on the repudiation. But it would seem that if the non-repudiating party chooses to declare the repudiation to be a breach or to rescind the contract, that would basically be an acceptance of the repudiation. The options of the non-repudiating party were already discussed in Section 9.4d.

For example, suppose Kia made a contract to buy a certain amount of silk from Visoth. If Kia told Visoth before the time for delivery that Kia was not going to perform the contract, that would be an anticipatory repudiation. In this situation, one of Visoth's options would be to treat the repudiation as a material breach. If Visoth did that, his duty to perform (deliver the silk) would be discharged, and he could also ask a court for a remedy for any damage caused by Kia's breach. Another option Visoth might choose would be to unilaterally rescind the contract. That would result in the discharge of all the duties under the contract. In that case, Visoth could not ask a court for remedies for the breach.

One requirement where a non-repudiating party treats an anticipatory repudiation as a breach and asks a court for remedies is that the party must show the court that he could have performed the contract if the other party had not repudiated. In other words, the non-repudiating party must show that he was willing and able to perform his duties under the contract at the time they were due.

For instance, in the silk example above, if Visoth decided to bring a lawsuit against Kia for breach of contract because of Kia's anticipatory repudiation, Visoth would have to show the court that Visoth could have delivered the silk according to the contract in order to get a remedy on the basis of the contract. If Visoth could not show this, he would not be able to recover for the breach.

Of course, if Visoth later made a different contract to avoid some of the damages he would suffer because of the breach, that would not prevent him from recovering anything. This is because courts wish to encourage parties to avoid damages. In fact, courts generally say that parties cannot recover damages which could reasonably have been avoided. This rule was already discussed in Section 9.4d, and it will be explained in detail in Section 10.6c.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies"), Section 10.6c contains further discussion of the rule that parties to contracts cannot recover for damages that they could reasonably have avoided.

*** ***CASE STUDY 217***

FACTS The Government made a "build-operate-transfer" (BOT) agreement with a large international company called Big Bear BOT Company to build and operate a new airport. Under the contract, the BOT Company agreed to build the airport, and the Government agreed to let the Company operate and earn money from certain parts of the airport for 20 years. At the end of that time, control of the airport would be transferred to the Government.

Several weeks before construction is due to start on the new airport, the BOT Company sends the Government a letter. The letter says that the BOT Company will not perform its contract. The Government tries to persuade the BOT Company to perform the contract, but has no success.

Finally, the government tells the BOT Company that it is treating the letter as a breach, and politely advises the Company to find a good lawyer. The Company says it will agree to end the contract and not ask for any money for all the trouble it had getting ready to perform. The Company says this means all the duties under the contract are discharged.

QUESTION OF LAW Are all the duties under this contract discharged?

DECISION No. The Government's duty to perform under the contract is discharged because it has decided to treat the BOT Company's anticipatory repudiation as a material breach, but the duties of the BOT Company under the contract are not discharged.

Where one party makes an anticipatory repudiation, the non-repudiating party has the option to treat the repudiation as a material breach, which may discharge the duty of the non-repudiating party to perform. In this case, the BOT Company told the Government that it would not perform its BOT agreement. This was an anticipatory repudiation, because it was a clear statement that the Company would not perform its contract duties. In response, the Government chose to treat the repudiation as a material breach, and ask a court for a remedy. One effect of this decision was that the Government's duties were discharged. The reason is that a court would probably find that the construction of the airport was a condition precedent to the Government's duty to allow the Company to operate it--since the construction had to happen first--and that the Company's breach means this condition will fail. Because the condition will fail, the Government's duties will not become due. In fact, they will be discharged in the same way as in the case of any other material breach. However, the BOT Company's duties are not discharged. They remain due for performance.

9.6d An Improper Rejection of a Tender of Performance May Discharge the Contract Duties of the Innocent Party

Sometimes one party properly tenders performance to another party, but the other party rejects that tender. Such an improper rejection will excuse any condition that consisted of the performance that was tendered. In that situation, the duty of the party who improperly rejects will become due for performance, even though the condition precedent or concurrent to that duty has not occurred. This was discussed in detail in Section 9.4g, above.

Of course, what is required for a "proper" tender will vary depending on what the contract says and what kind of contract it is. Obviously, contracts with express conditions have different standards from contracts with implied-in-law conditions, and certain kinds of contracts (like sale of goods contracts) may have special rules. So it is necessary to look carefully at all the circumstances to see which rules apply.

Another important effect of an improper rejection of a tender is that it may discharge the duties of the party who tendered the performance. The law actually treats this situation in a way that is similar to the way it treats a material breach.

Where one party improperly rejects a tender, the rejection suspends the duty of the party whose tender was rejected. It appears that, in most cases, the party who improperly made the rejection will then have some opportunity to cure his improper rejection, generally by actually tendering or performing his own duties under the contract within a reasonable time. If the party who improperly rejected a tender does perform his own duties in this way, then the other party's duty to perform--which had been suspended--will become due again!

But sometimes the party who improperly rejected a tender fails to cure his improper rejection. It may also be that the rejection cannot be cured. This could happen where the contract contained an express condition requiring performance not later than a certain time, or said that time was of the essence in the performance of the contract. In those situations, the duty of the other party will be discharged. Of course, this is similar to the rules about suspension and discharge of duties by material breach, which were discussed in Section 9.6b.

For example, suppose Sin agrees to sell his moto to Hong for $1,000, and the contract does not say when performance will occur. Suppose Hong tenders the money to Sin after a few days, but Sin improperly rejects the tender. This will suspend Hong's duty to perform. However, it will not discharge Hong's duty yet. Sin will still have some opportunity to cure his improper rejection. So if Sin comes to Hong and tenders the moto within a reasonable time--which may not be long for a sale of goods contract like this--then Hong's duty to pay will become due again! Of course, if that happens, Hong will also be given

a reasonable amount of extra time to get the money to Sin. But if Sin fails to cure or retract his rejection in this way, then Hong's duty to pay will be discharged. On the other hand, if the contract had specified a date for performance and said that time was of the essence, then it appears that Sin would not be able to cure his improper rejection any later than that date. Of course, Sin's duty to perform would still be due--since the condition concurrent to it would be excused by Sin's own improper rejection--and Hong could then ask a court for a remedy to compensate him for Sin's breach.

As noted above, it appears that this kind of improper rejection of a tender is treated in a way that is similar to a material breach. In fact, this kind of improper action might actually be considered a breach of an implied duty to cooperate, or the duty of good faith and fair dealing. Obviously, many parties would be prevented from performing if the other party simply refused to accept their tender of performance, as the moto sale example above shows. In addition, refusing to accept a proper tender might violate the duty of good faith and fair dealing if it was considered an attempt to seek unfair advantage, or a failure to follow reasonable standards of fair dealing. The moto sale example above might also be analyzed in this way. Wrongful prevention or hindrance of performance as an excuse of conditions was explained in Section 9.4h, and the duty of good faith and fair dealing was discussed in Section 9.5c.

9.6e The Occurrence of a Condition Subsequent May Discharge Contract Duties

Contract duties may also be discharged by the occurrence of a condition subsequent. As explained in Section 9.3b2 above, a condition subsequent is a condition that actually terminates a legal duty that is already due for performance. Obviously, this means that the occurrence of this kind of condition actually discharges the duty. Examples of conditions subsequent were already given in Section 9.3b.

Conditions subsequent do not occur often. One of the most common ways they occur is in insurance contracts. Suppose Chhay makes an insurance contract in which an insurance company agrees to pay for all damages to Chhay's house which are caused by certain potential events over the next year. The insurance contract may contain a clause saying that, if there is damage to the house which is covered by the policy, the insurance company's duty to pay for it will not become due unless Chhay gives the insurance company notice--properly tells the company about his claim for the damage--within 30 days after the occurrence of the damage. That notice would be a condition precedent to the insurance company's duty to pay the claim. If Chhay failed to give that notice, the insurance company's duty to pay would not become due.

But the same insurance contract might also say that, if Chhay gave that notice of the claim and caused the insurance company's duty to become due, but the insurance company failed to pay the claim, then Chhay would have only one year more to bring a lawsuit to force the company to pay

for the damage. The contract might say that if Chhay failed to bring such a lawsuit within one year, the insurance company's duty to pay would terminate. That failure to bring a lawsuit would be a condition subsequent, because its occurrence would cause the insurance company's duty to pay to terminate. And if that actually happened--if there was damage to Chhay's house that was covered by the policy, Chhay gave notice to the insurance company within 30 days, the insurance company failed to pay, and Chhay failed to bring a lawsuit within one year--then the insurance company's duty to pay for the claim would be discharged. So the occurrence of the condition precedent--the notice--would have caused the duty to pay to become due. But the occurrence of the condition subsequent--Chhay's failure to bring a lawsuit against the insurer within one year--would cause that same duty to be discharged!

9.6f Avoidance of a Voidable Contract May Discharge Contract Duties

As discussed earlier, a voidable contract is one that one party has the right to set aside or avoid. Voidable contracts may result from a failure to meet various formation requirements, such as capacity, mistake, misrepresentation, duress, or undue influence. These reasons, and the ability of parties to avoid such contracts, were explained in detail in Chapters 1 and 4-7.

If parties with the right to avoid these contracts choose to avoid them, it appears that this will discharge the duties of all the parties under the contract, unless those duties have already been discharged. This kind of discharge of duties might occur when the party with the right to set the contract aside does so, without going to any court. Or it might occur where that party uses his right to avoid as a defense to a lawsuit by the other party to enforce the contract. If one or more of the parties to a voidable contract have not yet completely performed, an avoidance by one party would appear to discharge the duties that have not yet been performed. If one or more parties have already completely performed their duties at the time of the avoidance, then it would seem that the duties of the parties who have performed are already discharged!

When a party avoids a contract, the law will generally try to provide restitution of the reasonable value of what the parties have provided to each other under the contract. Of course, as explained in Chapters 4-7, the parties in such contracts who do not have the right to avoid may not always be able to recover full restitution of what they have given under the contract.

For example, in Case Study 103, a minor named Much made a contract to purchase a watch for $20 from the S'aht Jewelry Company. If the parties had not yet exchanged the money for the watch, the effect of a disaffirmance by Much would appear to be that the duties of both parties would be discharged. If the parties had exchanged the money for the watch, the duties under the contract would already be discharged. So the effect of a disaffirmance by Much

would be that Much would have the right to restitution of his $20 from the S'aht Jewelry Company. Of course, Much would also have to return the watch if he still had it in his possession.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.3a, Chapter 4 ("Capacity"), Sections 4.4-4.6, Chapter 5 ("Legality"), Section 5.5a, Chapter 6 ("Formality"), Sections 6.3 and 6.7, and Chapter 7 ("Other Contract Formation Problems"), Sections 7.3-7.6 discuss voidable contracts.

9.7 A Later Agreement or Later Statement of the Parties May Discharge Contract Duties

Sometimes the parties to a contract make an agreement, or one party makes a statement, after the contract is formed, that causes the duties under the contract to be discharged. In other words, even though the duties under the contract have not been discharged by performance, breach, or some related event, one or both of the parties may be able to simply decide that the duties under the contract will be discharged.

Most of the ways to discharge duties that will be discussed in this Section are agreements between the parties. Often, such agreements to discharge duties are actually new contracts! In order for such contracts to be enforceable in common law jurisdictions, they must often--but not always--have consideration. This will be discussed further below.

This Section will discuss six important ways that parties may discharge contract duties by a later agreement or statement. These are through:

(1) a mutual rescission (Section 9.7a);

(2) a release (Section 9.7b);

(3) a substitute contract (Section 9.7c);

(4) an accord and satisfaction (Section 9.7d);

(5) a novation (Section 9.7e);

and (6) an account stated (Section 9.7f).

*** ***WHY IS THIS IMPORTANT?*** Why does the law say that parties may be able to discharge their contract duties merely by agreeing to do so after the contract is made?

Parties can agree to discharge contract duties--and end their contracts--for basically the same reasons that the law would enforce the contract itself. And in fact, the agreements to discharge duties discussed in this Section generally are new contracts themselves. The law generally wants parties to have the right to agree to affect their legal relations as much as they need

to in order to achieve their goals. This is one big reason why any contract is enforceable. There may also be special advantages for parties to be able to end their existing contracts. Sometimes contracts turn out to be a bad idea for the parties, or do not work out the way the parties hoped. The law wants to give parties the flexibility to react to these kinds of events, and to change their minds. Obviously, this will often make the parties happier.

These options may also result in a more efficient economy and judicial system. They give parties more freedom to do as they wish, and not waste time performing contracts that they no longer wish to perform. If the law said that parties could not agree to end their contracts, then some parties might feel that they had to perform their contracts, even though neither party thought it was a good idea. Of course, if all parties to a contract wish to end the contract, they could simply not perform it any more. As discussed earlier, courts have no power to interfere in contracts unless at least one party brings a dispute about the contract to the court. But if one party later changed his mind about ending the contract, that could lead to uncertainty and more legal disputes. The law wants to give parties the option to end their contracts and to know that the contracts are really ended. This gives the parties added security and certainty in conducting their affairs. It may also promote finality in the law, and reduce the number of disputes courts must resolve.

9.7a Mutual Rescission May Discharge Contract Duties

Sometimes parties simply decide to end their contracts, even though the contracts have not been fully performed. Parties can legally discharge all their remaining duties under a contract by agreeing to rescind that contract. This is called a mutual rescission.

*** **DEFINITION:** A **mutual rescission** is basically the cancellation of a contract by agreement of the parties.

Such a mutual rescission is actually a new contract, and the law will enforce it. That is, the law will enforce provisions in the new contract that say neither party can enforce the old contract!

The basic effect of a mutual rescission is that the contract ends, and no contract duties remain, although parties may still get restitution of benefits they have provided. Rescission was already introduced in Chapter 3 ("Consideration"), Section 3.7a.

For example, suppose Sophon and Eang make a contract to form a partnership to start an import-export business in the Pailin area. After the contract is made, the parties might decide that they do not wish to perform their contract because of security concerns. In that situation, the parties could agree to rescind their original contract. If they did, the duties in the original contract would be discharged. Neither party could enforce the contract,

although the parties would probably be able to get restitution of anything they had given to the other party under the contract.

It appears that a mutual rescission may be express or implied. For instance, in the Pailin example above, the parties made an express agreement to rescind their contract. However, a court might also find that such parties have impliedly rescinded contracts in certain circumstances. This might occur if the actions of the parties show clearly that they do not intend to perform the contract. For instance, if the parties in the Pailin example simply never took any actions to perform or enforce their contract for a substantial amount of time, a court might say that they had impliedly rescinded the contract.

Another situation where courts might imply a mutual rescission is where the parties actually modify their old contract or make a new one that changes the obligations the parties have under the old contract, but does not actually say it is mutually rescinding the old contract. In that situation, some courts may say that the parties have made an implied rescission, and may treat the old contract duties as discharged. This was already discussed in Chapter 3, Section 3.7a, and will be discussed again in the Sections below on substitute contracts (Section 9.7c) and accord and satisfaction (Section 9.7d).

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7a contains further discussion of modifications of contracts and mutual rescission.

There are two important limits on the ability of parties to mutually rescind their contracts. First, since a mutual rescission is a new contract, common law jurisdictions generally require consideration in order for such a rescission to be enforceable. If neither party has completely performed his duties under the contract, then there should be no consideration problem, since the consideration on each side is that each party gives up his right to the performance of the other party. But where one party has completely performed, there is no consideration from the other party--since that party has already received full performance, he is not really giving up anything in the rescission! In other words, there is no legal detriment to the party who has already received complete performance under the contract. So in these situations, common law jurisdictions generally say that mutual rescissions are not valid unless there is some new consideration, or unless some exception such as promissory estoppel (detrimental reliance) applies. If both parties have fully performed, then there would appear to be no need for a mutual rescission--the parties can simply make a new contract, if they wish.

A second limit is that a mutual rescission cannot affect the rights of third parties if those rights are "vested." This complex subject cannot be described in detail here. Basically, contracts sometimes affect more than two parties, often because one of the goals of the contract is to provide some benefit to a third party--a "third party beneficiary." In that situation, the two parties who actually make the contract cannot agree to rescind their contract

if that rescission would affect the "vested" rights of the third party beneficiary. Vested basically means the present property of the holder of the right. For example, if a party owned a car, the party's right of ownership would be a vested right. A mutual rescission cannot harm that kind of a right. The rights of third party beneficiaries are discussed in detail in Chapter 11 ("Third Party Rights and Duties"), Section 11.5.

For example, suppose Tan and Cheng agreed that Tan would pay Cheng a certain amount of money to build a house for Sopheap. Sopheap would probably be an intended third party beneficiary who would actually have the right to enforce that contract! The time when Sopheap's right to enforce might actually vest--so that no one could change it--varies in different jurisdictions. But the main idea here is that once Sopheap's right vests, Tan and Cheng cannot mutually rescind the contract without Sopheap's agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 11 ("Third Party Rights and Duties"), Section 11.5 discusses third party beneficiaries in more detail.

One way in which mutual rescissions are often not limited is with respect to writing requirements. It appears that many jurisdictions say that a mutual rescission does not generally have to be in writing--even if the original contract was required to be written! And it appears that many jurisdictions do not require such mutual rescissions to be written even if the original contract says it can be modified only by another writing. For example, suppose that two parties signed a residential lease for more than one year, in a jurisdiction where that kind of contract was required to be written to be enforceable. Many jurisdictions would say that those parties could mutually rescind that contract orally. However, laws in some jurisdictions have different rules. For example, the Uniform Commercial Code in the United States says that, where a signed sale of goods contract says that only a signed writing can modify or rescind it, that contract cannot generally be modified or rescinded in any other way. In addition, it appears that many jurisdictions say that an oral mutual rescission is not enforceable if it would cause a transfer of title to land.

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality") contains further discussion of situations where the laws of many jurisdictions say contracts must be written.

The general effect of a mutual rescission is that the contract is canceled, and that the parties have no obligation to perform it. This means that parties generally have no contract duties to perform. However, parties still generally have the right to restitution of any benefits they have provided to the other party under the contract, if they can show unjust enrichment, under the doctrine of quasi-contract. In this way, mutual rescission appears to be similar to unilateral rescission.

Of course, as with unilateral rescission, parties must be careful that they do not give up the right to enforce the contract by mutual rescission

unless they really intend to do so! The reason is that restitution may not be as good a remedy as enforcement of the contract in some situations. Laws in some jurisdictions do say that parties who mutually rescind contracts still have the right to ask a court for a remedy under the contract. For example, the Uniform Commercial Code in the United States says that parties to sale of goods contracts still have that right in the case of a mutual rescission or a unilateral rescission. But in general, it appears that parties do not have that right. So they must think carefully before they agree to rescind their contracts. The effect of unilateral rescission was already explained in Section 9.6b, which discussed discharge by breach.

For example, suppose Naro agrees to harvest Sonneath's rice crop for a certain price per hectare. If the parties mutually rescind the contract after Naro has harvested half the crop, many jurisdictions say that Naro has no right to be paid under the contract for his work! Of course, Naro can ask a court for restitution of the reasonable value of what he has done for Sonneath. But that may not be as much money as what Naro would have received under the contract itself.

*** ***CASE STUDY 218***

FACTS On November 1, Kien agrees to buy a car from the Speedy Car Company for a certain price. The car is scheduled to be delivered on December 1. Unfortunately, on November 25, Kien loses her job. So she goes to the Speedy Car Company and asks if the Company will agree to rescind the car sale contract. The Company agrees to rescind, hoping that Kien will come back and buy a car when she finds a new job.

Several months pass, and the Company is unable to sell the car. It decides to ask a court to force Kien to obey the original contract. Kien says all the duties under that contract are discharged.

QUESTION OF LAW Are all the duties under the original car sale contract discharged?

DECISION Yes. The duties under the original contract are discharged because Kien and the Company made a new contract to mutually rescind the old one.

When the parties to a contract agree to mutually rescind that contract, the contract is canceled and all the duties under the original contract are discharged. In this case, Kien and the Speedy Car Company made a contract for Kien to buy a car from the Company. However, after Kien lost her job, she asked the Company if it would agree to rescind the contract. The parties agreed that the contract would be rescinded. That means that all the duties under the old agreement were discharged. So the Company can no longer enforce the old agreement against Kien.

It would appear that a mutual rescission could also have additional consideration on one or both sides. For example, suppose the Speedy Car Company in Case Study 218 would not agree to the mutual rescission unless Kien also agreed to pay $50. In that case, the terms of the rescission would be that the Company would agree to give up its rights under the contract in exchange for Kien's agreement to give up her rights under the contract and to pay $50 to the Company.

9.7b A Release May Discharge Contract Duties

Sometimes a party who has already fully performed may wish to give up his right to receive the performance of the other party to a contract. This cannot generally be done with a mutual rescission in common law jurisdictions, because there would be no consideration, as discussed in Section 9.7a. However, it might be done with a signed document called a release.

*** **DEFINITION:** A **release** is a document signed by a party in which that party discharges a duty that is owed to him.

A release is not an agreement. It is a document signed by one party. A release may discharge contract duties that are not yet due for performance, or duties that are due and have not been performed. In contract situations, it would seem that releases are most often used when the duty of only one party to the contract remains to be performed--including the situation where one party expressly gives up his right to sue another party for breach of the contract. But releases are not used only in contract situations. For example, a party may also use a release to give up his right to pursue different kinds of legal claims he may have against another party, such as tort claims.

It appears that many jurisdictions require that a release be a writing signed by the party discharging the duty in order to be valid. So there appear to be two important requirements for releases to be valid in many jurisdictions:

(1) the release must be in writing;

and (2) the release must be signed by the party discharging the duty owed to him.

The other rules about releases vary in different jurisdictions. Some common law jurisdictions say that a release must have consideration to be valid. So the party whose duty was being discharged by the release would have to agree to some new legal detriment (often a payment of money) in order for the release to be valid. In that situation, it would seem that the release would be merely one part of a contract between the parties. Other common law jurisdictions appear to say that consideration is not required for a release, or at least that it is not required for particular kinds of contracts, such as sale of goods contracts. That would mean one party could discharge the contract

duties of another party even if the party whose duties were being discharged agreed to nothing in exchange for the release.

For example, suppose Sem borrowed 10,000 riels from his cousin Man. If Sem had difficulty repaying 7,000 riels of this money, he might ask Man to sign a release discharging Sem's duty to repay the rest of the money. Man might agree to this simply in order to be nice to his cousin, or because it would be too much trouble to bring a lawsuit against him. In that situation, there would be no consideration, because Man has agreed to give up his right to receive the rest of the money, but Sem has agreed to nothing new. However, that would still be a valid release in some common law jurisdictions, as long as the release was written and signed by Man. Other common law jurisdictions might require that there be some new consideration for the release to be valid. For instance, the release might be valid in those jurisdictions if Sem agreed to buy Man a large bowl of noodle soup in exchange for the release. The following Case Study contains another example of a release.

*** ***CASE STUDY 219***

FACTS Oung's Sewing Company, a new business, agreed to buy 100 square meters of a certain material from the Soft Silk Company. The contract said that Oung would pay the full price of the silk within 30 days after the silk was delivered. The Silk Company delivered all the material according to the contract.

However, 30 days passed, and the Silk Company received no payment. The Company asked Oung to pay, but Oung said that she did not have all the money yet, since her clothes were not selling as quickly as she hoped they would. Oung begged the president of the Silk Company to have faith in her, and not to require that she pay for all the silk right away.

The president of the Silk Company knew Oung was hard-working and an excellent seamstress. The president also knew that if Oung's new business was a success, the Company would be able to sell her a lot more silk. So the president decided that she would help Oung get her new business started. The president signed a document stating that all Oung's duties under the contract were discharged, and sent it to Oung. Oung thanked the president many times and vowed to work twice as hard to make her business a success, but she could not believe this meant she did not have to pay for the silk.

QUESTION OF LAW Are Oung's duties under this contract discharged?

DECISION Yes, in many jurisdictions. The duties under this contract would be discharged in many jurisdictions because the president of the Silk Company made a valid release discharging Oung's duty to pay for the silk.

The duties of a party to a contract may be discharged where the party to whom the duties are owed signs a document called a release stating that those

duties are discharged. Some common law jurisdictions require consideration in order for a release to be valid, but others do not.

In this case, the president of the Silk Company decided to help Oung get her new sewing business started by not requiring her to pay for the shipment of silk, as she normally would have had to pay under the contract between the parties. To do this, the president signed a release. The effect of this signed document in many jurisdictions would be to discharge Oung's duties to pay for the silk--even though there was no consideration to support the president's promise. Some common law jurisdictions would require consideration. In those jurisdictions, Oung would have had to agree to do something in order for the release to be valid.

Releases may seem similar to mutual rescissions, since both basically end contracts. But actually the two ideas are different in several important ways. First, a release must generally be a signed writing, whereas a mutual rescission can generally be oral. Second, a release is basically a statement by one party, whereas a mutual rescission is always a new contract between the parties. Third, a release sometimes does not need consideration to be valid in common law jurisdictions, but a mutual rescission generally does.

9.7c A Substitute Contract May Discharge Contract Duties

Sometimes the parties to a contract simply wish to end their contract and make a new agreement that substitutes a different duty of performance for the duty owed under the original contract. One way they can do this is by making a substitute contract.

A substitute contract is basically a new, different contract between the parties that immediately discharges the old contract between the parties. A substitute contract occurs where the evidence shows that the intention of the parties was to create a new contract and immediately discharge the duties under the old contract. If such a new contract does not immediately discharge the duties under the old contract, then it is an accord, which will be discussed in Section 9.7d, below.

In general, substitute contracts seem to happen where one party has fully performed under an existing contract and the other party has not. In particular, substitute contracts seem most common where one party owes the other party money under the existing contract.

Of course, in some cases it can be hard to tell whether the parties intended a substitute agreement or an accord. When parties do not state their intentions so clearly, there are a few general guidelines many courts use to help them decide this difficult issue. One guideline is that, where parties make a new agreement about an existing contract under which money is owed, and the amount of a debt that remains to be performed is not disputed, courts generally assume that the parties' new agreement is an accord.

But where the amount of the debt that remains to be performed is disputed between the parties, then courts generally assume the parties intended a substitute contract. Another rule that some jurisdictions seem to apply is that the more formal the new agreement is, the more likely it is to be a substitute contract. This is further discussed in Section 9.7d, which examines accord and satisfaction.

An important effect of a substitute agreement is that it immediately discharges the duties in the old contract. That means that as soon as the substitute contract takes effect, the old contract is discharged. So if one party fails to perform the substitute agreement, the other party may ask a court to enforce that substitute agreement--but not the old agreement. The reason is that all the duties under the old agreement have been discharged.

For instance, in the loan example in Section 9.7b, where Sem borrowed 10,000 riels from his cousin Man, Sem had trouble repaying the last 7,000 riels. Suppose that, instead of Man signing a release, the parties made a new agreement. Under the new agreement, Man agreed to cancel immediately the 7,000 riels outstanding debt, and Sem agreed to loan Man his bicycle for some period of time. In that situation, there would be a substitute agreement, because the parties would have agreed to immediately discharge Sem's duty to pay under the old agreement, and replace the old agreement with a new agreement. The new agreement is that Man agrees to cancel the 7,000 riels debt that Sem owes him, and in exchange Sem agrees to loan Man a bicycle for a certain amount of time. If Sem fails to loan Man the bicycle as required by the substitute agreement, Man can ask a court for a remedy for that breach. But Man cannot ask a court to enforce the old agreement requiring Sem to repay the outstanding debt of 7,000 riels, because the duties under that contract were immediately discharged when the substitute agreement took effect. This kind of agreement was also discussed in Chapter 3 ("Consideration"), Section 3.6a, which explained some exceptions to the general rule that part payment of a debt is not consideration in common law jurisdictions.

A substitute contract might also be considered a modification of the old contract. For this reason, some common law jurisdictions require that there be some new consideration on each side in order for it to be valid. The new consideration might be that each party agrees to do something that is at least slightly different--even if it is not necessarily more difficult than what the party had previously agreed to do! Of course, laws in some jurisdictions say that no consideration is required for modifications of any contracts, or for modifications of sale of goods contracts, or for modifications of contracts in which one party has had substantial unforeseen difficulties. This was discussed in Chapter 3, Section 3.7.

A substitute contract must generally be written if the original contract was required to be written. This is because, as discussed above,

the substitute contract really is a kind of modified agreement, and many of the general rules about contracts apply.

*** ***CASE STUDY 220***

FACTS Lak and Phanna made an agreement under which Lak borrowed $2,000 from Phanna in order to improve the irrigation systems on Lak's farm. Under the contract, Lak was required to repay the money in one year at 10% interest, for a total repayment of $2,200.

However, six months after Lak received the money, he realized that it would really take longer than he thought to make all the improvements he needed. He also realized that it would be better if he was not required to repay the money he had borrowed for two years, instead of one year. So Lak talked to Phanna about the contract. Together, the parties agreed to a new contract, under which the old contract would be discharged immediately, Lak would repay the money in two years instead of one year, and the repayment would be $2,500, instead of $2,200.

Six months after the parties made the new agreement, Lak is surprised when Phanna asks for the $2,200 under the original loan contract! Phanna says he can still enforce the old contract if he wants, and that he needs the money now. Lak says he will not be able to repay the money until the next year.

QUESTION OF LAW Can Phanna still enforce the original loan agreement?

DECISION No. Phanna cannot enforce the original loan agreement because all the duties under that contract were discharged by the substitute contract the parties made.

When parties to a contract make a substitute contract, the duties under the original contract are discharged immediately. A substitute contract occurs where the evidence shows that the intention of the parties was to create a new contract and immediately discharge the duties under the old contract.

In this case, Phanna and Lak made a loan agreement under which Phanna loaned Lak $2,000, to be repaid in the amount of $2,200 in one year. But six months later, the parties made a new contract that said that the original debt was canceled, and that Lak would instead pay Phanna $2,500 two years from the date of the old agreement. This was a substitute agreement, because it is clear that the parties intended to discharge immediately the duties under the old contract and substitute the new one. So in this case, where Lak's duty to pay under the old contract was immediately discharged, Phanna cannot enforce the old agreement. He can enforce only the new agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.6a explains some exceptions to the general rule that part payment of a debt is not consideration in common law jurisdictions, and Section 3.7 discusses the general common law requirement of consideration for contract modifications; and Chapter 6 ("Formality"), Section 6.5 discusses the general rule that if the law required an original contract to be written to be enforceable, a modification of that contract must be written to be enforceable.

9.7d An Accord and Satisfaction May Discharge Contract Duties

An "accord" occurs where the parties to a contract make a new contract that substitutes a different duty for a duty owed under the original contract but that does not immediately discharge the duty under the original contract. Instead of immediately discharging the old duty, an accord merely suspends the old duty until the new one is fully performed. The complete performance of the new duty is called a "satisfaction." Only when there is a "satisfaction" is the old duty discharged.

*** **DEFINITION:** An **accord and satisfaction** occurs where the parties to an existing contract make a new contract that substitutes a different duty for a duty owed under the old contract (the "accord"), and then that new duty is actually performed as required by the new contract (the "satisfaction").

So the "accord" is the new contract the parties make, and the "satisfaction" is the actual performance of the duty described in the accord. Of course, since parties do not always perform their contract duties, not every "accord" is followed by a "satisfaction!"

Although accords are similar to substitute contracts, the big difference between an accord and a substitute contract is that a substitute contract discharges the duties under the old contract immediately, whereas an accord merely suspends those duties until there is a satisfaction. If the satisfaction does not occur--because a party has failed to perform his new duties--then the innocent party has two choices. Specifically, that party may ask for a remedy for the other party's breach of:

(1) the old agreement;

OR (2) the new, accord agreement.

It appears that, like substitute contracts, accords generally change the duty of only one of the parties to the contract, and that they tend to occur where the party whose duty will change owes the other party some amount of money. Of course, as with substitute contracts, it also appears possible that an accord could change the duties of both parties.

For example, in Case Study 220, Phanna loaned Lak $2,000, and Lak agreed to repay $2,200 in one year. But the parties later changed their contract, and agreed that Lak would repay $2,500 in two years,

instead of $2,200 in one year. Because the parties agreed that the old contract would be immediately discharged, the new contract in Case Study 220 was a substitute contract. However, if the parties in Case Study 220 had not agreed that the old contract would be immediately discharged, but that the old contract duty would merely be suspended, then the new agreement would have been an accord. The accord would have suspended Lak's duty to perform under the old contract--his duty to pay $2,200 in one year. But that duty would not have been discharged until Lak actually performed the terms of the new contract, by paying $2,500 in two years. That would be the satisfaction. If Lak failed to pay $2,500 in two years, then Phanna would have the choice of asking a court for a remedy for Lak's failure to perform the original contract (by paying $2,200 in one year), or his failure to perform the accord (by paying $2,500 in two years).

Some common law jurisdictions say that an accord--like a substitute contract--must generally have new consideration on both sides to be valid. But as with substitute contracts, it appears that it is enough that the new consideration be of a different type--even if that type is not necessarily as valuable as the old consideration! For instance, in the example above where Sem agreed to loan Man the bicycle to substitute for the remaining amount due under their loan contract, the loan of the bicycle would be new consideration, even if it did not appear to be as valuable as the 7,000 riels still due under the old contract.

In addition, an accord may occur where a party agrees to accept less than that party claims is due under the old contract, as long as there is a good faith dispute about the amount due. Consideration exists here because the creditor is agreeing to give up his right to pursue his legal claim to the extra money. For example, if Man and Sem had a good faith dispute about how much Sem really owed--perhaps because the debt was old--Man could make an accord to accept less than he originally claimed was due, and the original debt would be discharged when the new amount was paid. This was already discussed in Chapter 3 ("Consideration"), Section 3.6a.

As noted above, the big difference between accords and substitute contracts is that substitute contracts discharge duties under the old contract right away, and accords do not. When the parties' new contract actually says whether the parties intend this to happen or not, it is easy to tell which kind of agreement the new contract is. However, sometimes parties do not state their intentions so clearly. When that happens, it can be difficult to know which kind of new contract the parties made! There are a few general guidelines many courts use to help them decide this difficult issue when the new contract does not clearly show the intentions of the parties. Two of these general guidelines are explained below.

The first guideline is that, where the amount of the debt that remains to be performed is not disputed, courts generally assume that the parties' new agreement is an accord. But where the amount of the debt that remains

to be performed is disputed between the parties, then courts generally assume the parties intended a substitute contract. The reason for this rule is that, where there is no dispute about the amount due, the creditor party is less likely to want to give up the option to ask for a remedy under the original contract. So the creditor is more likely to intend an accord, which gives him that option. But where there is a genuine dispute about the amount due, the creditor is more likely to be willing to give up his right to ask for a remedy under the old contract, in order to get the certainty of at least one clear promise--the new promise in the substitute agreement. Of course, it is possible for parties to create a substitute contract where the amount is not disputed, and it is possible for parties to create an accord where the amount is disputed, as noted above.

A second rule that some jurisdictions seem to apply is that the more formal the new agreement is, the more likely it is to be a substitute contract. The reason for this rule appears to be that courts do not assume that parties are giving up their rights under the original agreement unless it is clear that they are really creating a full new agreement to take its place. More formal agreements are more likely to show that this is what the parties intended.

Illustration: Comparison: Accords and Substitute Contracts

	ACCORD	**SUBSTITUTE CONTRACT**
1. What is it?	A new contract that substitutes a different duty for one owed under an old contract between the same parties	A new contract that substitutes a different duty for one owed under an old contract between the same parties
2. What is the legal effect?	Suspends duty under original contract until satisfaction occurs	Discharges duty under original contract immediately
3. When is it most likely to occur?	Where amount of debt is not disputed	Where amount of debt is disputed
4. What are the key differences?	(a) Does not discharge original duty immediately (b) Likely where amount of debt not disputed	(a) Discharges original duty immediately (b) Likely where amount of debt is disputed

*** ***CASE STUDY 221***

FACTS Chhom, who caught fish on the Tonle Sap for a living, owed Kimtong 100,000 riels under a loan contract. But Chhom was having trouble finding the money to repay Kimtong. Chhom asked Kimtong if he would accept a certain quantity of fish instead of the 100,000 riels.

Chhom promised to provide all the fish within the next week. Kimtong agreed to this arrangement.

Kimtong returned a week later to get the fish from Chhom. But Chhom said he had no fish. Kimtong said he was sorry, but that he would have to ask Chhom for the 100,000 riels, or else ask a court to help him get it. Chhom said he would try to give Kimtong some fish soon, but that his duty to pay Kimtong the 100,000 riels was already discharged.

QUESTION OF LAW Was Chhom's duty to pay Kimtong 100,000 riels discharged by the new agreement the parties made about the fish?

DECISION No. The new contract the parties made was an accord, so Kimtong still has the option to ask for a remedy under the new contract (for the fish) or the old contract (for the 100,000 riels).

An accord exists where the parties to a contract make a new contract that substitutes a new duty for a duty owed under the old contract, but does not immediately discharge the duty owed under the old contract. Where there is no dispute about the amount due, and no evidence the parties intended a substitute agreement, courts generally assume the parties have made an accord.

In this case, Chhom and Kimtong agreed that Kimtong would accept a certain amount of fish instead of the 100,000 riels that Chhom owed him under their original contract. Here, the amount due was not disputed, and there is no other evidence that the parties intended a substitute contract. So the parties' new agreement was an accord. That means that Chhom's duty to pay the 100,000 riels under the old contract was not discharged. When Chhom failed to provide satisfaction of the accord--by failing to provide the fish he had promised--Kimtong had two options: he could ask a court for a remedy either for Chhom's failure to repay the 100,000 riels, or for Chhom's failure to provide the fish.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.6a explained some exceptions to the general rule that part payment of a debt is not consideration in common law jurisdictions, and Section 3.7 explained the general common law requirement of consideration for contract modifications and the exceptions to that rule.

9.7e A Novation May Discharge Contract Duties

In some cases, the two parties to a contract agree with a new party that the new party will substitute for one of the current parties to the contract, and that all the duties under the original contract will be immediately discharged. This is a novation.

*** **DEFINITION:** A **novation** is generally defined as an agreement to substitute a new party for one of the parties to an existing contract, and to immediately discharge the duties under the original contract.

The duties created under the new contract are often the same duties as under the old contract--with different parties. However, it appears that the new duties need not be the same as the old ones for a novation to exist. In any event, the result of a novation is that the duties in the original contract between two parties are discharged, and that a new contract between one of the original parties and a new party is formed.

Many jurisdictions say there are four requirements for a valid novation to occur:

(1) a previous contract;

(2) an agreement among the parties to that contract and a new party;

(3) an intention by those parties to immediately discharge the duties under the previous contract;

and (4) an enforceable new contract between the new party and one of the parties to the previous contract.

Consider the following Case Study.

*** ***CASE STUDY 222***

FACTS Sineam, the manager of a pharmacy, had an employment agreement with Sereyvuth. Sereyvuth had agreed to work as a clerk at the pharmacy for six months. However, one week before Sereyvuth's job was to start, Sereyvuth got an opportunity to study overseas. Sereyvuth and his friend Leang went to see Sineam, and asked if Leang could take Sereyvuth's place in the pharmacy contract. The three parties agreed that Leang would take Sereyvuth's place as a clerk at the pharmacy, and that the duties under the old contract would be discharged immediately.

However, a few days later, Sineam changed her mind. She decided that she would rather have Sereyvuth as her clerk than Leang, and she told Sereyvuth that he would be required to honor his original contract. Sereyvuth asked the court for help.

QUESTION OF LAW Can Sineam enforce her original contract with Sereyvuth?

DECISION No. Sineam cannot enforce her original contract with Sereyvuth because Sineam, Sereyvuth and Leang made a novation, under which Leang took Sereyvuth's place as the pharmacy clerk, and the duties under the original contract with Sereyvuth were immediately discharged.

A novation occurs where the parties to a contract agree to substitute a new party for one of the parties to an existing contract, thus forming a new contract. Specifically, many jurisdictions say there are four requirements for a novation: (1) an existing contract; (2) an agreement among the parties to that contract and a new party; (3) an intention to immediately discharge the duties under the original contract; and (4) an enforceable new contract.

In this case, Sineam and Sereyvuth had a contract under which Sereyvuth was supposed to work for Sineam as a clerk for six months. But later Sineam, Sereyvuth and Leang all agreed that Leang would substitute for Sereyvuth as the clerk, and that the duties under the original contract would be immediately discharged. This was a novation, because the parties to an existing contract (Sineam and Sereyvuth) agreed with a new party (Leang) that Leang would take Sereyvuth's place as the pharmacy clerk--creating an enforceable new contract--and that the duties under the original contract between Sineam and Sereyvuth would be immediately discharged. Because the duties under the original contract were immediately discharged, Sineam cannot enforce that original contract against Sereyvuth.

As noted above, it appears that the duties under the new contract need not be the same as under the old contract in order for a valid novation to occur. For example, in Case Study 222, it appears the parties could have agreed that Leang would work for a longer period, or that Leang would perform a different job, and that would have created a valid novation.

A novation is similar to--but not the same as--other legal events involving a new party which are called assignment of rights and delegation of duties. These complex subjects cannot be fully explained here. But very generally, an assignment of rights occurs when a party to an existing contract transfers his rights under the contract to a third party. A delegation of duties occurs where a party to a contract transfers his duties under the contract to a new party. Either one or both of these two kinds of transfers can occur with regard to a particular contract. There are limits on these transfers, but unlike novations, they do not require the agreement of the other party to the original contract. Also unlike novations, they do not immediately discharge the duties under the original contract. So if a party delegates his duties to a new party, and the new party fails to perform, the other party to the original contract can still enforce the original contract against the delegating party. The duties under the original contract are not discharged. Assignment of rights and delegation of duties are discussed in more detail in Chapter 11 ("Third Party Rights and Duties"), Sections 11.3 and 11.4.

For example, in the Case Study 222 situation, Sereyvuth might have been able to assign his rights and delegate his duties under the contract to Leang without Sineam's agreement. But even if Sereyvuth could do that, the original contract would still be enforceable against Sereyvuth if Leang failed to perform the duties in it correctly.

*** ***ADDITIONAL REFERENCE:*** Chapter 11 ("Third Party Rights and Duties"), Section 11.3 discusses assignment of rights, and Section 11.4 discusses delegation of duties.

9.7f An Account Stated May Discharge Contract Duties

Parties often have more than one transaction together. In many cases, one party does not perform his duties at the time of each transaction. In other words, one party becomes a creditor of the other party with respect to the contracts. In that situation, the parties sometimes make an enforceable agreement about the correct amount owed by the debtor to the creditor because of the prior transactions. This kind of agreement can save the creditor the task of having to prove to a court the amounts of all the individual transactions. And it can save both parties the trouble and uncertainty of a dispute about the correct amount. Such an agreement is called an "account stated."

*** **DEFINITION:** An **account stated** is an agreement between a creditor and a debtor that a particular sum is the correct amount the debtor owes to the creditor.

The effect of an account stated in many jurisdictions is to discharge immediately the duties from the transactions that the account stated summarizes. So the account stated creates a new, generally larger duty, and most jurisdictions seem to say that it discharges all the prior duties that it includes. Although the account stated discharges the prior duties, it appears that a party may still make a claim that the account stated was the result of a mistake. An account stated generally need not be written unless the prior agreements were required to be written.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 (“Other Contract Formation Problems”), Section 7.3 explained when agreements may be invalid because of mistake.

An account stated may be express or implied. Sometimes the parties to some contracts negotiate with each other about the correct total amount owed, and the amount on which they finally agree--expressly--is the account stated. It appears that the most common way for an account stated to be implied is where a creditor gives or sends a debtor a statement summarizing the total amount due under some prior transactions. If the debtor holds the statement and fails to object within a reasonable time to the amount in the statement, a court will say that the debtor has impliedly agreed that the stated amount is accurate. In that situation, the creditor may ask a court for a remedy using the account stated as his evidence, and he need not prove facts about all the prior transactions summarized in the account stated.

*** ***CASE STUDY 223***

FACTS Naty sold vegetables at the market. Every day, Naty sold onions and tomatoes to Karn, a wealthy merchant. And every day, Karn said that she would pay for the vegetables the next day.

After some time had passed, Naty handed Karn a statement that listed all the vegetables Naty had sold Karn over many days, along with the prices of all the vegetables and a total amount due. Naty also kept a copy of the statement for herself. Karn merely smiled and went away.

A few weeks later, Naty saw Karn at the market again. Karn tried to avoid Naty, but Naty approached her and asked for the money. Karn said: "Who can remember what I might have bought so long ago? Go away!" Naty asked the court for help.

QUESTION OF LAW Can Naty use the statement she gave Karn at the market to get a court to order Karn to pay her the amount on the statement?

DECISION Yes. Naty can use the statement to get a court to order Karn to pay that amount, unless Karn can prove it was the result of mistake, because the statement Naty gave Karn was an account stated, to which Karn agreed by failing to object within a reasonable time.

An account stated is an agreement between a creditor and a debtor that a particular stated sum is the correct amount the debtor owes to the creditor. Such an agreement generally discharges the duties due under the prior transactions it summarizes. An account stated may be created expressly or impliedly.

In this case, Naty gave Karn a written list of the vegetables Karn had bought from Naty over many days, and the total amount due. Karn went away for several weeks, and never objected to the amount in the statement. This was an implied agreement to the amount in the account stated, and it discharged the duties under the prior transactions between Naty and Karn. Therefore, Naty can use this account stated to prove the amount Karn owes her, and she need not prove the amount of each particular sale.

Of course, if Karn can prove the amount in the document is a mistake, then she will have to pay only the correct amount. But it might be difficult to prove such a mistake, because as Karn herself said, "Who can remember what I might have bought so long ago?"

9.8 The Operation of Law May Discharge Contract Duties

Contract duties may also be discharged by operation of law, even if they are not discharged by performance or some related action, or by a later agreement or statement of the parties. In other words, sometimes

the law itself says that the duties in a contract are discharged, regardless of the actions of the parties themselves. This Section will discuss five ways that contract duties may be discharged in this way:

(1) impossibility or impracticability of performance of the contract (Section 9.8a);

(2) frustration of the purpose of the contract (Section 9.8b);

(3) bankruptcy of one of the parties (Section 9.8c);

(4) a final court judgment or arbitration award about the contract (Section 9.8d);

and (5) the passing of the time set by a statute of limitations (Section 9.8e).

9.8a Impossibility or Impracticability of Performance May Discharge Contract Duties

After a contract is formed, something may occur that makes the performance of the contract impossible or highly impracticable. Many jurisdictions say such an event will discharge the duties in the contract if:

(1) performance really is impossible or highly impracticable;

(2) neither party caused the event; and

(3) neither party assumed the risk of the event.

These requirements will be discussed in more detail below.

The general effects of impossibility or impracticability are that the duties under the contract are discharged and the contract is ended. Of course, parties may be able to recover restitution of benefits they have provided under the contract.

For example, suppose Rim made a contract to teach French to Samon every day for two months for a certain fee. If Rim died right after the contract was made, it would obviously be impossible for Rim to perform the contract duties. In that case, the duties under the contract would be discharged, and the contract would be ended.

In the past, it appears that courts did not allow a party's duties to be discharged unless performance of those duties was actually impossible. In other words, the duties of that party would not be discharged by events that occurred after the contract was made--no matter how difficult or dangerous those events made the performance of the contract--unless the events made that performance impossible. An example of a truly impossible performance would be the situation above involving Rim and the French lessons. And it appears that some jurisdictions still follow this strict rule.

However, many other jurisdictions now say that duties may also be discharged if events cause performance of contract duties to be highly impracticable, even if that performance is not actually impossible. For instance, in the French lessons example above, suppose Rim did not die, but did lose the use of his voice and could not move from his bed. In that case, it might still be possible for Rim to give French lessons. Rim could give the lessons in writing, from his bed. But because of Rim's unexpected disability, it would probably be highly impracticable for him to perform. So courts might say that the duties of the parties were discharged. However, the category of events that are impracticable is limited. This is because courts are usually reluctant to say contract duties are discharged unless they really are impossible or extremely difficult to perform. In any case, for ease of use, and because performances that are "impossible" are also "impracticable," this text will generally use the term "impracticable" to include both kinds of problems with contract performance.

(1) Basic Requirements and Effects of Impracticability

As noted above, not all events that make performance of contract duties difficult will actually cause those duties to be discharged. This is true even in jurisdictions that say duties may be discharged because of impracticability, rather than only because of actual impossibility.

This Section will discuss the requirements for duties to be discharged in jurisdictions that say duties may be discharged because of impossibility or impracticability. Specifically, many of these jurisdictions say that three basic requirements must be met for contract duties to be discharged in this way:

(1) an event occurs that makes performance impracticable;

(2) the party claiming impracticability did not cause the event;

AND (3) the party claiming impracticability did not assume the risk of the event occurring.

Each of these requirements will be discussed below.

(1) An event must make performance of a contract impracticable in order for that event to discharge duties under the contract. The most obvious requirement is that some event occur that makes performance of the contract impracticable. Some of the most important types of situations where this may occur are where the performance becomes illegal, where a person necessary for the contract to be performed dies or becomes incapacitated, or where the specific subject matter of the contract is destroyed. These situations will be discussed in more detail below.

The most important part of this requirement is that the performance actually be impracticable. Obviously this standard will be met where the performance is impossible--since everything that is impossible

is also impracticable! However, if performance is not actually impossible, it must be extremely difficult in order to qualify as "impracticable." It is not enough that performance merely becomes more difficult than the parties expected, or that a party must find a way to perform that differs from the way he expected to use. In addition, it is not enough that the performance becomes more expensive. As noted above, many jurisdictions say that the increased cost or difficulty of performing the contract must be extreme in order to be considered impracticable. However, an increased cost that is so severe that it clearly involves an unreasonable economic waste might make a performance impracticable.

For instance, in the above French lesson example, suppose a change in a land use law forced the teacher Rim to live in a new location across town that was much farther away from where he had planned to give lessons to Samon under the contract. This might make it more expensive or difficult for Rim to travel to the lessons. But it would probably not make the performance legally impracticable.

However, if Rim was forced by a civil war to move to a new home several hundred kilometers away--so that the only way he could give the lessons would be by telephone, or traveling all the way back and forth to the lessons each day through intense fighting--then it would be extremely difficult, expensive, and/or dangerous for Rim to perform the contract. That would probably be enough to be impracticability.

Some authorities say that the impracticability must be "objective," meaning that the performance would be impracticable for any person to do. These authorities say it is not enough that performance merely be impracticable for the particular party to the contract. If other people could perform the contract, but the particular party involved in the contract cannot, that would be "subjective" impracticability. Many courts would say that would not be sufficient to meet this first requirement. Following this rule, many courts say that events such as a party losing all his money or a party losing all his employees (perhaps because of a labor strike) would be only "subjective" impracticability, and so such events would not be sufficient for the party's duties to be discharged.

However, this objective/subjective rule does not always seem to work well. For example, although courts say that being unable to perform because of a loss of money or employees is not impracticability, most courts also say that the death or incapacity of parties to personal service contracts--such as Rim in the first French lesson example above--is impracticability and will discharge duties. This would seem to violate the objective/subjective rule. The reason is that the problem in the first Rim example above was that the particular party Rim could not perform because he died--not that no one in the world was able to teach French to Samon!

It may be that a better way to analyze these situations would be not to discuss objective or subjective impracticability, but simply to ask whether a party claiming impracticability assumed the risk of the problem, as will be discussed below. Under that analysis, it may be that parties assume the risk that they will lose their own money or lose their own employees, but do not assume the risk of their own death or physical incapacity. But even this analysis is not perfect. Perhaps courts simply consider it more fair to hold a party responsible for losing money or employees than for losing the party's own life or health.

It is also important to remember that the impracticability must be caused by an event that occurs after the contract is made. If the event causing the impracticability occurs before a contract is formed, the result depends on rules discussed earlier in this text.

If an event occurring before the contract is formed actually makes the performance of the proposed contract impossible, then it would seem that there could be no valid contract, generally because the parties made a bilateral mistake. Many jurisdictions also say that, if an offer has been made but not accepted at the time of an event makes performance impossible, then the offer will automatically terminate, at least in some situations. For example, this would be the case if an event caused the death or incapacity of a person necessary to perform the contract, caused the performance of the contract to become illegal, or destroyed the specific subject matter of the offer. These rules were already discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Sections 2.6c-e; Chapter 5 ("Legality"), Section 5.5a; and Chapter 7 ("Other Contract Formation Problems"), Section 7.3a.

If an event occurring before the contract is formed makes the performance impracticable but not impossible, and the parties are aware of this fact--if there is no mistake--then it would appear that a valid contract could still be formed. In that situation, it would seem that the party whose performance had become more difficult might have agreed to accept that difficulty, and that the contract might be enforceable. Presumably the party would not be able to avoid the agreement on the basis of mistake, since he was aware of the situation before he made the agreement.

However, suppose one or both parties were not aware of the impracticability at the time they made their agreement. Then the party or parties who did not know probably would have a claim that the contract was invalid on the basis of mistake, as discussed in Chapter 7, Section 7.3. If one party did not know about the problem but the other party did know, then the party who did not know might also be able to avoid the agreement on the basis of misrepresentation, as discussed in Chapter 7, Section 7.4.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Sections 2.6c-e discussed ways offers terminate when the proposed contract becomes impossible; Chapter 5 ("Legality"), Section 5.5a

discussed how illegality can prevent agreements from being valid, or terminate existing offers; and Chapter 7 ("Other Contract Formation Problems"), Section 7.3 explained when agreements may be invalid due to mistake, and Section 7.4 explained when agreements may be invalid due to misrepresentation.

(2) The party claiming impracticability must not have caused the event that caused the performance to be impracticable. This second requirement appears to be designed to prevent parties from escaping contracts merely because they no longer wish to perform them, or simply because of their own carelessness. It may also be that the law feels that parties generally assume the risk that their own actions will cause a contract performance to become impracticable.

For example, suppose a party makes a contract to sell his car, but before the time for performance the party negligently destroys the car in a crash. The party's duties under the contract will probably not be discharged because of impracticability. Of course, the contract can no longer be performed. But it would appear that the other party to the contract would be able to ask a court for a remedy for the negligent party's failure to perform (provide the car).

(3) The party claiming impracticability must not have assumed the risk of the event which causes the impracticability. This requirement basically means that a party's duties will not be discharged because of impracticability where either the contract or the law says that the party assumed the risk of the kind of event that caused the impracticability. This analysis is somewhat comparable to the assumption of risk analysis many courts use in determining whether a party has assumed the risk of a mistake, as explained in Chapter 7, Section 7.3a.

In general, parties may agree to assume certain risks in their contracts. This can occur either expressly, or impliedly, where a contract lists other risks the parties will not assume, but fails to include the event that has actually occurred. For instance, in the French lesson contract above, the parties could expressly agree that Rim would assume the risk that he would be forced to live hundreds of kilometers away. If Rim assumed that risk, his duties under the contract would not be discharged on the basis of impracticability.

In addition, the law says that parties assume certain risks in certain situations. This is a very difficult topic, and authorities do not seem to provide clear and consistent rules about it. Perhaps the most important risk that the law generally says all parties assume is the risk that market prices and expenses will change substantially. For example, in the French lesson contract, the law would say that Rim assumes the risk that prices for such lessons will go up substantially--thus making the contract unfavorable to him. And Samon assumes the risk that the prices for such lessons will go down substantially--thus making the contract unfavorable to him.

However, it appears that many jurisdictions say that parties do not generally assume the risk that performance of the contract will become extremely difficult. It appears that such jurisdictions feel such extreme changes may result from unexpected events such as disasters which the parties assumed would not occur, such as war, embargoes, or crop failures. Obviously, it might not always be easy to tell the difference between this kind of change and the price changes described above. Perhaps one rule to help decide whether a party assumed a risk would be to say that the more extreme and unexpected an event is, the less likely a party assumed the risk that it would occur.

The law also says parties assume other risks in certain situations. For example, as discussed above, it appears that parties generally do not assume the risk that they will become unable to perform a personal services contract because of their own death or incapacity. But it seems that parties generally do assume the risk that they will become unable to perform because they lose their money or their employees.

In addition, parties who agree to buy or work on a specific subject matter generally do not assume the risk that that specific subject matter will be destroyed. This rule generally applies to sale of goods contracts, before the risk of loss has passed. It also seems to apply to many contracts to do construction work. However, it appears that a builder who makes a contract to build a whole building generally does assume the risk that the building will be destroyed before he finishes it! This will be further discussed below.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.3 explained the situations when many jurisdictions say that parties assume the risk of mistakes in their contracts.

The general effect of impracticability is that the duty of the performance that has become impracticable is immediately discharged. Some authorities appear to say that the impracticability discharges the entire contract (including all duties). Even if not all the duties were automatically discharged, if the impracticable performance was a condition precedent or concurrent to the duty of the other party--as in a sale of goods contract--then the duty of the other party would not become due. If the impracticable performance is not a condition, then it would appear that the duty of the other party may technically become due, but that a court will not find that other party is liable for any failure to perform the duty. If duties are discharged by impracticability, parties may still be able to recover restitution of any benefits they have given to the other party under such contracts. Impossibility as an excuse of conditions was already discussed in Section 9.4j, above.

Sometimes impracticability is only temporary, and performance will become practicable again after some period of time. In that situation, the temporary impracticability suspends--but does not discharge--the duty of performance. However, the duty will still be discharged if

the temporary impracticability causes a great hardship to one or both of the parties. This kind of hardship might occur either because one or both parties must wait too long to see if the duty will revive, or because the duty will be much more difficult for the party to perform after the impracticability ends.

For instance, in the French lesson example, if Rim's inability to teach was only temporary, his duty might have been merely suspended until it could be performed. But if the delay would have caused Rim or Samon great hardship, then the duty would probably have been discharged.

(2) Some Important Situations Where Impracticability May Occur

Impracticability may occur in a variety of situations. Several of the more common types of these situations are discussed below.

(1) Illegality -- One of the most important types of impracticability occurs where, after a contract is made, the performance of the contract becomes illegal. This is sometimes called "supervening illegality." This type of situation was already discussed above.

The effect of this kind of illegality is that the duties under the agreement are discharged. In addition, it would appear that restitution might be available to the parties in this situation. Although the general rule is that parties to illegal agreements cannot even get restitution, it would seem that unjust enrichment would be likely in many cases where an agreement became illegal after it was formed. It would not seem that contract parties should take a loss because they failed to predict that the government would decide their contract was illegal after they made it! The effects of illegality on proposed contracts before the contracts are actually formed were discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6e, and Chapter 5 ("Legality"), Section 5.5a.

For example, in Case Study 67, an offer from a logging company called Nagalogs to a wood buyer called Dee Mak automatically terminated when it became illegal to perform the contract because of a new law passed by the National Assembly. If Dee Mak had accepted the offer before the new law was passed, then a valid contract would have been formed. But the effect of the new law would have been to discharge the duties under that agreement, and neither party could have enforced the agreement.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6e discussed how offers terminate when the proposed contract becomes illegal; and Chapter 5 ("Legality"), Section 5.5a discussed how illegality can prevent agreements from being valid.

(2) Death or Incapacity of a Person Necessary for the Performance of a Contract -- If a party or other person who is necessary for the performance

of a contract dies or becomes incapacitated after the contract is formed, then the duties under the contract will be discharged. This type of situation was already discussed above, and in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6c.

However, in this situation, the legal analysis is somewhat different before a contract is formed and after a contract is formed. Before a contract is formed, the law is most concerned with whether a real and knowing agreement can occur, and whether the parties have capacity. If one of the parties is dead, a real agreement cannot occur. Parties who are dead or adjudicated incompetent lack capacity. In addition, if a necessary party dies or becomes physically unable to perform for other reasons, then the proposed contract might be invalid because of mistake. An event like that would also terminate an offer, in many jurisdictions. These ideas were discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6c; Chapter 4 ("Capacity"), Sections 4.2 and 4.5; and Chapter 7 ("Other Contract Formation Problems"), Section 7.3.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6e discusses how offers can terminate when a party or person necessary to the proposed contract dies or is adjudicated incompetent; Chapter 4 ("Capacity"), Sections 4.2 and 4.5 discuss the capacity of parties who are dead or adjudicated incompetent; and Chapter 7 ("Other Contract Formation Problems"), Section 7.3 discusses agreements that are invalid because of mistake.

After a contract is formed, the important issue is whether it is impracticable to perform it. A contract performance may become impracticable because of the death or physical or mental incapacity of one of the parties, or of a third party who is necessary to the performance. This is most likely to occur in personal service contracts, where services may be "unique," rather than other types of contracts, such as sale of goods contracts.

For instance, in the French lessons example above, the death or incapacity of either the teacher Rim or the student Samon would discharge the duties under the contract. Both of those parties were necessary to the performance of the contract, which was a personal service contract involving unique services (teaching). In the same way, if Samon had hired Rim to teach French to Samon's daughter, and the daughter had died, the duties under the contract would have been discharged, because the daughter was also necessary to the contract.

However, it is also possible that even a party will not be necessary to the performance of a contract if the duties under the contract could be delegated (transferred) to someone else. For example, if Rim's contract was merely to sell Samon some French books, Rim's death might not discharge the duties under the contract, because those duties might easily be delegated to someone else. In addition, if the French contract merely said that Rim would supply

a French teacher for Samon from a group of several teachers Rim employed, it would appear that the duties under the contract would not be discharged, because the contract could still be performed by one of the other teachers. It seems that such duties could be delegated by the legal successor of the incapacitated or deceased party, such as his guardian or the executor of his estate. Delegation of duties was briefly discussed in Section 9.7e above, which explained novations, and it will be further discussed in Chapter 11 ("Third Party Rights and Duties"), Section 11.4.

*** ***ADDITIONAL REFERENCE:*** Chapter 11 ("Third Party Rights and Duties"), Section 11.4 discusses delegation of duties.

(3) Destruction of a Contract's Specific Subject Matter -- When the specific subject matter of a contract is destroyed after the contract is formed, the duties under the contract may be discharged. Like the first two situations described above, this type of situation was already discussed earlier in this Section. In addition, the effects of destruction of a specific subject matter before a contract is formed were discussed in Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.6d, and in Chapter 7 ("Other Contract Formation Problems"), Section 7.3a.

For example, suppose a group of students make a contract with a large hotel to rent a particular room with an excellent view of the river in order to have a graduation party. If the hotel burns down after the contract is formed, but before the party is scheduled to occur, the duties of the parties under the contract will be discharged. In that situation, the specific subject matter of the contract--the room in the hotel--has been destroyed.

However, as noted in Chapters 2 and 7, these rules apply only if the contract was about a specific subject matter. For example, if the contract describes a specific building, a specific car, or identified goods such as a particular cow or a particular painting, then the destruction of those items may discharge the duties under the contract. But if a contract is simply for the sale of 10 kilos of potatoes, or 100 tons of rubber, the duties will generally not be discharged, because those are not specific subject matters. And this is true even if the seller was thinking about a particular group of goods when he made the contract.

Another limit on this rule is that impracticability will not discharge contract duties where the risk of loss of the subject matter has passed from the seller to the buyer. The most common situations where this limit is applied are sale of land contracts and sale of goods contracts. Although sale of goods contracts will be briefly discussed below, these subjects can be very complex, and the rules about them vary in different jurisdictions. So it is important to check the local law that relates to these types of contracts.

In general, it appears that the duties of the parties under a contract for the sale of particular goods will be discharged if the goods are destroyed

before the risk of loss passes from the seller to the buyer. Some jurisdictions have special rules that govern when the risk of loss of goods actually passes in all contracts for the sale of goods (including where the goods have been specifically identified).

For example, under the Uniform Commercial Code in the United States, it appears that whether the duties in a sale of goods contract will be discharged by the destruction of the goods depends on whether the risk of loss of the goods has passed from the seller to the buyer. It appears that these rules basically say that the risk of loss does not pass until the goods reach a certain point in their journey from the seller to the buyer. Depending on the contract, that point may be when the buyer gets the goods at the seller's address, when the seller gives them to a carrier (such as a delivery company or messenger), or when the carrier actually delivers the goods to the buyer. Before those points in time, it would appear that the risk of loss has not passed to the buyer. In those situations, if the goods destroyed were specifically identified, then the contract duties could be discharged because of impracticability. If the goods were not specifically identified, the duties would not be discharged, and the seller would have to find different goods to provide to the buyer. But after the risk of loss has passed to the buyer, the duties under the contract will not be discharged, and the buyer must pay for the goods even if they are destroyed.

These rules also apply in special ways in construction contracts. First, the general rule appears to be that the duties of a builder who makes a contract to construct a building will not be discharged if the building is destroyed before he is finished. The main reason for this rule appears to be that courts feel the builder assumes the risk of this destruction--or perhaps that some courts feel that the unfinished building was not yet a "specific" subject matter. This can be a harsh rule, especially since the builder may have trouble even getting restitution, since he might be unable to show that he gave any benefit to the owner of the land--who has received only a destroyed building! On the other hand, where a party agrees to repair an existing building, it appears that most courts say the duties of the repairing party will be discharged if the building is destroyed. It may be that courts believe the repairing party does not assume this risk--or that the existing building is a "specific" subject matter.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance"), Section 2.6d, and Chapter 7 ("Other Contract Formation Problems"), Section 7.3a discuss the effects of destruction of the specific subject matter before a contract is formed.

(4) Natural and Human Disasters -- Sometimes events that might be described as "disasters" cause the performance of contracts to become impracticable, often by making the performance of the contracts extremely difficult or expensive. Potential examples include crop failures, earthquakes, floods, wars, and trade embargoes.

Many jurisdictions say that these events will discharge the duties under the contracts if they meet the three requirements discussed above. Sometimes these kinds of events will actually destroy the specific subject matter of a contract. Other times they may make the subject matter impracticable to find or supply, or make the means of performing the contract impracticable. It appears that some courts may allow the duties under a contract to be discharged by these kinds of events even if it is not so clear that there really was a "specific" subject matter. One way to explain this result would be to say that parties do not always assume the risk that such a subject matter will be destroyed or become inaccessible, if the events that cause the problem are extreme and unexpected enough. Compare the two Case Studies below.

******* ***CASE STUDY 224***

FACTS Nareth, who fishes in the Tonle Sap, makes a contract to supply a certain quantity of a valuable fish called the blue-tailed redfish to the Special Fish Company for the next two years. All the fish will come from the Tonle Sap, since that is the only place they are known to exist.

Unfortunately, after Nareth has supplied the redfish to the Company for a few months, the fish suddenly disappear. Environmental experts say the problem is that a new dam project has caused many of the fishing stocks to change--or even disappear! Now no one knows where the blue-tailed redfish are, or if they will ever return. Nareth tells the Fish Company that he cannot complete performance of the contract. But the Company says it will ask a court to enforce the contract.

QUESTION OF LAW Will a court enforce this contract?

DECISION Probably not. This contract has probably become impracticable because of the environmental changes caused by the construction of the new dam, so a court would probably say that the duties under the contract have been discharged.

Duties under a contract may be discharged on the basis of impracticability where an event causes performance of the contract to be impracticable, the event is not the fault of the party claiming impracticability, and the party claiming impracticability has not assumed the risk of the event occurring.

In this case, Nareth agreed to supply the Special Fish Company with a special kind of fish--the blue-tailed redfish--from the Tonle Sap. Unfortunately, soon after Nareth started to catch the fish and perform the contract, all the fish disappeared because of the construction of a big new dam project. Now no one knows where the fish are, or if they will ever return. In this situation, catching the redfish has become impracticable. It may or may not be possible to find the fish, but it would clearly be extremely difficult. In addition, Nareth did not cause the problem. Finally, it is unlikely that Nareth

assumed the risk of this kind of extreme, unexpected environmental problem in making his contract to catch and sell the redfish. Therefore, the remaining duties under this contract will probably be discharged, and the Special Fish Company will be unable to enforce the contract with respect to any further supplies of the fish.

*** ***CASE STUDY 225***

FACTS A farmer named Kheng makes a contract to sell 10 tons of his next rice crop to the Rice Supply Company. However, not long after the contract is made, there is a terrible drought. Kheng's crop and almost all of the other rice crops in the area fail.

Kheng tells the Rice Company that he is unable to supply any rice. But the Company says it will enforce the contract.

QUESTION OF LAW Can the Rice Company enforce this contract against Kheng?

DECISION Perhaps not, at least in some jurisdictions. This contract may have become impracticable because of the rice crop failure caused by the severe drought, and courts in some jurisdictions might say that the duties under the contract have been discharged.

Duties under a contract may be discharged on the basis of impracticability where an event causes performance of the contract to be impracticable, the event is not the fault of the party claiming impracticability, and the party claiming impracticability has not assumed the risk of the event occurring.

In this case, a drought caused Kheng's rice crop to fail, and prevented him from performing the parties' rice supply contract as he had intended. First, it appears that some jurisdictions might find that this contract was impracticable. This seems to be the case even though Kheng's inability to supply may be "subjective" in the sense that he cannot supply the rice, but it would obviously be possible for someone, somewhere to supply it. Of course, it might also be argued that the parties actually made their contract about a "specific" subject matter, because they both knew that the rice was to come from Kheng's rice fields. It may also be that such jurisdictions simply say that a rice grower like Kheng does not assume the risk of extreme and unexpected crop failures like this. Second, Kheng did not cause the crop failure. Finally, as noted above, it appears that some jurisdictions would say that Kheng did not assume the risk of a crop failure like this. Therefore, some jurisdictions might find that the duties under this contract are discharged, and that the Rice Company cannot enforce the contract.

Some courts and authorities might not agree with the result in Case Study 225. These authorities might say that the contract was not

really impracticable, since Kheng could have bought rice on the market to perform the contract, although that rice might have been more expensive. It might also be argued that farmers should be considered to assume the risk of droughts and crop failures, and that such events are not really unexpected. What do you think?

*** ***WHY IS THIS IMPORTANT?*** Why do courts in some jurisdictions say that duties may be discharged by impracticability, even if it is not actually impossible to perform a contract?

It appears that the law is trying to balance competing interests in this difficult area. In general, the law wants to enforce contracts and to require that parties perform their contracts. That is why the law says that duties will not be discharged merely because they have become more difficult or expensive. It could also be said that the law says parties generally "assume the risk" that their performances will become more difficult or expensive.

On the other hand, some jurisdictions now also say that if performance has become extremely difficult--and a party did not assume the risk that that would happen--then the duties under the contract may be discharged because of "impracticability." It appears that the law in some jurisdictions wants to give courts a little more flexibility to allow parties to escape contracts because of unforeseen events that change the performance of contracts severely, such as wars, embargoes, or crop failures like the one in Case Study 225.

However, even in jurisdictions that apply this kind of rule, it appears that courts have been very reluctant to allow parties to escape contracts on the basis of impracticability. This is especially true where the events could have been foreseen--such as if the parties knew that a war might occur when they made the contract--or where the unexpected events make the performance of a contract more expensive, but not extremely so. Most courts appear to say that parties assumed the risk that those kinds of events would occur.

In general, the problem of when duties should be discharged because of impracticability is an example of one of the more basic problems in contract law. Courts generally want to enforce contracts as they are written, so that parties can rely on their contracts and the economy can work efficiently. On the other hand, courts want to avoid the unfairness and economic waste which might result if parties were required to perform duties that had become impossible--or almost impossible. The analysis of when parties "assume the risk" of an event is one way to try to solve this problem.

9.8b Frustration of Purpose May Discharge Contract Duties

In certain cases, events may occur after a contract is formed that make performance of the contract <u>useless or valueless</u> to one of the parties--even though the performance is not impossible or impracticable! In other words, although the contract can be performed, the <u>main purpose of the contract</u>

has been destroyed. In this situation, the duties to the contract may be discharged because of a "frustration of purpose."

Frustration of purpose is a limited doctrine. Many jurisdictions say that contract duties will be discharged on this basis only where all four of the following requirements are met:

(1) both parties understood the main purpose of the contract at the time the contract was made;

(2) some event has made the contract performance almost or totally valueless to one of the parties;

(3) the party claiming frustration of purpose did not cause the event;

AND (4) the event was unexpected and the parties assumed it would not occur.

If all of these requirements are met, the duties under the contract are discharged. Of course, as with impracticability, parties may generally be able to get restitution of benefits they have given to the other party under the contract.

*** ***CASE STUDY 226***

FACTS Every year, there is a large public celebration of the birthday of the King. The celebration includes parades, ceremonies, and various other entertainment. Most of the events can be observed from the houses on a certain street.

One year, the owner of one of these houses, who is named Yon, decides to rent the roof of his house to Sok for the day of the celebration. Both parties understand that the purpose of the contract is so Sok will have a good view of the King's birthday celebration.

Unfortunately, the day before the King's birthday, the celebrations are moved to a different location! This location is many kilometers from Yon's house, and there is no way to see the festivities from Yon's house anymore. Sok says he will not perform the contract. Yon asks a court for help.

QUESTION OF LAW Will the court order Sok to obey this contract?

DECISION No. The duties under this contract will be discharged because the purpose of the contract--to watch the King's birthday celebrations--has been frustrated.

Contract duties will be discharged because of frustration of purpose where: (1) both parties understood the main purpose of the contract at the time the contract was made; (2) some event has made the contract performance totally valueless or almost totally valueless to one of the parties;

(3) the party claiming frustration of purpose did not cause the event; and (4) the event was unexpected and the parties assumed it would not occur.

In this case, Sok made a contract to rent the roof of Yon's house for one day in order to watch the King's birthday celebrations. Unfortunately, after the contract was made, the celebrations were moved to a different site far away. In this situation, both parties understood the main purpose of the contract: for Sok to watch the birthday celebrations. But the move of the celebrations made the contract completely valueless to Sok, because he had no other reason to rent Yon's roof. Sok did not cause the event to be moved. And the move was clearly unexpected--the celebration had been held in the same place for years, and if the parties had thought it would be moved, they never would have made their contract. Therefore, all the requirements for frustration of purpose are met, and the contract duties will be discharged. Sok will not be required to obey the contract.

Courts rarely find that duties are discharged because of frustration of purpose. Courts are especially reluctant to use the doctrine when an unexpected event means that a party will not be able to earn as much money on a contract, but the event does not really frustrate the purpose of the whole contract.

For example, suppose a party makes a long-term contract to lease a gasoline station on a small road that is scheduled to be built into a major highway. If the plans to make the road larger are canceled after the gasoline contract is made, the duties of the party who leased the gasoline station will probably not be discharged because of frustration of purpose. In that situation, the contract is not really valueless, since the party can still sell gasoline at the station. In fact, what has been frustrated is the party's plans to make a lot of money, rather than the main purpose of the contract (to sell gasoline). This kind of situation is sometimes called "commercial frustration." It is usually not considered to be frustration of purpose.

One example of situation where a kind of "commercial" frustration might discharge duties would be where party makes a contract to lobby a government for approval of a certain project, but immediately after the contract is formed the government decides it will not pursue or actually outlaws that kind of project. In that situation, a party might be able to meet the four requirements above for frustration of purpose.

9.8c Bankruptcy Proceedings May Discharge Contract Duties

When the debts of a person become too much for that person to pay, laws in many jurisdictions provide that the person may begin bankruptcy proceedings in court, and seek protection from his creditors. Bankruptcy is complex, and it cannot be fully explained here. In general, bankruptcy laws are intended to resolve a debtor's obligations in a fair way, and give the debtor a chance to make a new financial start. In many cases,

one result of bankruptcy proceedings is that not all creditors are paid the full amount that was owed to them. The rules about bankruptcy vary in different jurisdictions, so it is important to check the local law.

Obviously, many of the affairs that bankruptcy proceedings resolve are contracts. When the liability of a person under a particular contract is resolved in bankruptcy proceedings, the duties under that contract are generally discharged, and the only duties that remain are any that are created in the bankruptcy proceeding. Of course, as discussed in Chapter 3 ("Consideration"), Section 3.8b, many jurisdictions say it is possible for a bankrupt person to renew his duty to pay at a later time, if he voluntarily agrees to repay the debt and the bankruptcy court approves. In addition, contracts are not automatically discharged merely because a person begins bankruptcy proceedings. The result depends on what happens in those proceedings.

For example, suppose Tha has many debts that he cannot resolve. One of these debts is the remaining balance of a loan Tha received some time ago from a money lender named Sothy. This balance is 100,000 riels. Finally, after trying every other way he can to pay his debts, Tha decides to file for bankruptcy protection. In the bankruptcy proceedings, it is decided that Sothy will be able to receive only 50,000 riels of the amount owed to him. This means that Tha's old debt will be discharged, and Sothy will no longer be able to enforce it.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.8b discusses bankruptcy proceedings, and how parties may renew debts that have been discharged in bankruptcy.

9.8d A Final Court Judgment or Arbitration Award about the Contract May Discharge Contract Duties

Courts and arbitrators often resolve disputes about the performance of contracts. Usually these disputes occur when one or both parties claim that there has been a breach of the contract. When a contract dispute is resolved by a final judgment of a court or a proper award of an arbitrator, the duties under the original contract are generally discharged.

Of course, if the court judgment or arbitration award says that a party must pay money or perform some other act, the party still has the legal duty to perform that act. Parties must obey valid court judgments and arbitration awards. But the duties under the original contract are discharged, and neither party to the contract will be able to enforce the original contract, or to bring another lawsuit about that contract. In this situation, courts often say that the duties under the original contract are "merged" into the judgment or award.

*** ***CASE STUDY 227***

FACTS Atra and Chea made a contract under which Chea was to sell Atra two flat bed crane trucks. Atra needed the trucks for some work she planned to do. But Chea never delivered the trucks according to the contract.

So Atra asked a court for a remedy. The court found that Chea had breached the contract by failing to deliver the trucks. The court issued a judgment that said Chea had to pay Atra damages to compensate her for money she had lost because she did not receive the trucks according to the contract.

However, Chea did not pay the money required by the court judgment. So Atra brought another lawsuit about the contract! But Chea said the duties under that contract were discharged.

QUESTION OF LAW Are the duties under the original contract discharged?

DECISION Yes. The duties under the original contract were discharged when the court issued its judgment about that contract. Atra will have to ask the court to enforce the court judgment, not the original contract.

When courts issue judgments to resolve contract disputes, those judgments generally result in the discharge of the duties under the original contract, since those duties are "merged" into the court judgment. In this case, Chea breached his contract with Atra, and Atra obtained a judgment that said Chea had to pay her damages for that breach. The effect of the judgment was to discharge the duties under the original contract, and merge them into the court judgment. Therefore, Atra can no longer enforce the original contract. She will have to ask the court to enforce the court judgment.

*** ***ADDITIONAL REFERENCE:*** Chapter 10 ("Remedies") contains further discussion of what courts may do when there is a contract dispute.

9.8e The Passing of the Time Set by a Statute of Limitations May Discharge Contract Duties, or at Least Bar a Lawsuit about the Contract Duties

Statutes of limitations are statutes that say how much time a party has, after a certain type of legal claim arises, to make that claim in court. Under these statutes, if a party who is harmed by a contract breach waits too long to try to enforce the contract, that contract will no longer be enforceable by the party. Statutes of limitations were already introduced in Chapter 3 ("Consideration"), Section 3.8d.

It appears that many jurisdictions say that the passing of the time set by a statute of limitations does not actually discharge the duties

under the contract, but that it bars the judicial remedy. In other words, the duties of the parties are not discharged, but provided the issue is properly raised in court, the court will not enforce the contract! As a practical matter, this means that a party must tell the court about the statute of limitations problem--raise it as a defense in court--or else that defense is waived. If the defense is waived, then the court case can proceed despite the statute of limitations.

On the other hand, it appears that some jurisdictions say that the expiration of the time set by the statute of limitations actually discharges the contract duties. That would mean that there would be nothing left for a court to enforce.

For example, in Case Study 101, Samen and Sorit made a contract for the sale of a generator. Sorit delivered the generator, and Samen failed to pay for it. However, Sorit waited too long to bring a lawsuit about this breach. The statute of limitations said that parties had only five years to bring such a lawsuit, but Sorit failed to bring a lawsuit within six years. Many jurisdictions would say that the effect of Sorit's failure to bring the lawsuit within five years was not that Samen's duty to pay for the generator was discharged, but that if Samen properly raised the statute of limitations problem in court, the court would not enforce the contract. However, some jurisdictions would say that Samen's duties were actually discharged by the passing of the time set by the statute of limitations.

One aspect of statutes of limitations was already discussed in Chapter 3, Section 3.8d. This is the rule in common law jurisdictions that a new promise to perform a contract duty that is no longer enforceable because of the statute of limitations generally needs no consideration to be binding.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.8d contains further discussion of the effects of statutes of limitations on contract disputes.

9.9 Performance of Contracts in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of current Cambodian law and the civil law tradition to contract performance appear to produce practical effects that are generally compatible with those of the approach discussed in this Chapter. These legal traditions do not always use the same terminology as that used in this Chapter. So it is important to check the law that applies to any particular contract.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) contains several provisions relevant to the discussion of contract performance in this Chapter. These are discussed below.

One important difference is that Decree #38D does not appear to contain provisions that specifically discuss "conditions," although there are some rules about specific types of contracts that may achieve effects that are similar to the effects of conditions.

General Provisions about Performance

Decree #38D contains a number of general provisions about how parties are to perform contracts, and a few about what happens if the parties fail to perform properly. As noted earlier, Article 30 states that each party to a contract is a "debtor" regarding the duties to be performed by him, and a "creditor" regarding the rights that he is to receive. Article 29 provides that parties shall carry out their contract obligations "in a timely and proper fashion especially with regard to quality, quantity, place and duration prescribed." These would appear to be terms that Decree #38 regards as important in the performance of a contract. In addition, Article 32 says that, unless the contract states otherwise, it shall be executed at the residence of the debtor. And Article 33 provides that, if there is no specific duration of time within which to execute the contract (presumably in the contract itself or the law), then the debtor can perform at any time and the creditor can request payment at any time.

Failure to Perform

Article 31 describes the options of creditors when the debtor fails to perform according to the contract. First, Article 31 states that the creditor party shall not be compelled to accept an object other than that to which he is entitled, even if the value of the object tendered is equal to or higher than the object the contract specifies. This might be roughly comparable to some of the rules about proper tender described in this Chapter, and it might be particularly comparable to a "perfect tender" rule.

Article 31 also provides that the creditor party shall not be compelled to accept part performance of the contract, but appears to give the People's Court discretion "with regard for the spirit of goodwill and the financial situation of the debtor party" to extend the time for execution of the contract and to suspend the creditor's legal action. The law notes that this is a "special case," and requires that the court exercise great care in these situations and clearly state its reasons for any such decision. Article 31 probably gives the court more discretion to suspend the duties of debtors than courts in most free market jurisdictions have.

In addition, Article 24 provides that the debtor party to the contract shall satisfy his obligations by payment from his personal and real properties available now and in the future. This may mean that, if a party fails to perform his duties under the contract, a court may order that his obligations be satisfied from the above properties.

Honesty and Good Faith

Article 2 provides that parties to a contract shall collaborate in an atmosphere of "good conscience," and that contracts shall be executed "according to the principles of social ethics especially so as to abolish the exploitation of one party by another." In addition, Article 22 states that contracts shall be performed "honestly and in accordance with the purposes agreed upon by the parties." These provisions may describe a contract duty comparable to the duty of good faith and fair dealing described in this Chapter.

How Duties May End

Decree #38D contains several provisions related to how duties may end. First, Articles 25-28 describe the statute of limitations with respect to contracts. Article 25 provides that obligations resulting from a contract will have expired if the creditor party fails to sue for performance within five years of the date defined in the contract, or if there is no such date, the date the parties made the contract. Article 26 provides that the limitation period will be postponed if the debtor has been absent from his residence and the absence has been "certified by the local authorities according to the law," and that the limitation period will also be postponed by a complaint by the creditor. Article 27 provides that the debtor or guarantor may assert the statute of limitations in court, but that if that does not occur, then the court "shall do it instead." Article 28 states that a debtor or guarantor who performs under the contract after the limitations period has expired cannot make a "claim for the amount of money or value given" on the grounds that the limitation period has expired.

In addition, Article 3 of Decree #38D provides that, for contracts to be valid, the subject matter of the contract must be "possible to perform" and "lawful." It would appear that if the subject matter of a contract became impossible or unlawful after a contract was formed, then the contract would cease to be enforceable, as described in this Chapter.

Article 16 of the Labor Law (1997) appears to prohibit contracts in which a person agrees to work in order pay off a debt. This provision would seem to forbid substitute contracts and accords that involve a debtor in a loan contract agreeing to work for the creditor in order to pay the debt. This Article appears to limit the freedom of contract in order to protect debtors.

Performance of Particular Types of Contracts

Chapter 2 of Decree #38D regulates the performance of specific types of contracts in some detail. The provisions in Chapter 2 contain a number of provisions which may be roughly comparable to some of the provisions discussed in this Chapter relating to conditions, breach, impossibility, rescission, and other matters related to performance.

For example, Articles 34-55 govern sales contracts. Article 38 provides that, in sales contracts, the seller will be liable for damage occurring until the time of delivery, and that the sale may be "canceled" if the item is lost or substantially damaged prior to delivery "or when the vendor cannot find a substitute." If the sale is canceled, Article 38 appears to say that the seller must pay damages to the purchaser resulting from the loss of the object or any damages resulting from the fault of the seller. These rules may be roughly comparable to the rules discussed above relating to impossibility.

Article 47 provides that if the seller dies, his duties pass to his heirs. This would seem to be like the rule discussed above that duties may not be discharged because of the death of a party who is not really necessary to the performance of the contract, which might be the case in a sales contract.

Article 53 provides that the seller may keep possession of the sale item up until the purchaser delivers payment. This rule might be comparable to the rule discussed above involving concurrent conditions in sale of goods contracts.

Articles 54 and 55 discuss rescission of sale of goods contracts. Article 54 provides that the seller may rescind the contract if the buyer has failed to make full payment by the due date. Article 55 describes how the parties are to be returned to the positions they would have occupied if the contract had not been made, including the payment of interest. These rules seem comparable to the rules about rescission discussed above, though the remedy in Article 55 seems closer to reliance than restitution.

*** ***CIVIL LAW PERSPECTIVE:*** The practical effects of the civil law approach to contract performance appear to be generally comparable to the effects of the approach discussed in this Chapter. However, civil law jurisdictions do not use all of the same terminology as in the discussion above. And of course, the exact rules about contract performance differ from one jurisdiction to another, so it is always important to check the relevant local law.

Civil law jurisdictions appear to have very detailed statutes governing the performance of contracts in many different situations. For example, in Germany, the law defines the rights and duties of the parties with respect to performance of contracts in a variety of situations. It appears that some authorities group these many detailed provisions into three categories: impossibility, delay in performance, and "positive breach," which appears to refer to a defective performance that is not delayed, such as providing non-conforming goods. In each of these situations, the parties have different rights in different circumstances. France also has many detailed statutes governing contract performance. For example, there appear to be more than 10 different statutes regulating the sale of goods.

Conditions exist in at least some civil law jurisdictions. For example, French contract law contains a number of provisions about conditions.

It seems that such conditions may be either precedent or subsequent, and that the Civil Code provides various rules about how they work. For example, if a condition is impossible to fulfill, illegal or immoral, then it is "void."

In addition, as discussed in Chapter 7 ("Other Contract Formation Problems"), civil law jurisdictions say that all contracts contain a duty which is comparable to the duty of good faith and fair dealing discussed in this Chapter. This duty applies to the performance of contracts. For example, the laws of France and Germany impose this duty.

Many civil law jurisdictions appear to limit the use of the doctrine of impossibility to situations where performance of the contract really is impossible, rather than merely impracticable. For example, it seems that impossibility is a very limited doctrine in France. It also appears that French law requires that performance actually be impossible, as well as "unforeseeable" and "irresistible," in order for contract duties to be discharged. There does seem to be an exception for contracts involving personal performance. However, it appears that German law does generally allow performance to be excused for reasons comparable to what was described as impracticability in this Chapter.

As noted above, it appears that civil law jurisdictions have detailed statutes governing performance of different types of contracts. One important example is the sale of goods. As noted above, French law has many different statutes regarding this type of contract. Germany also has special rules about sale of goods contracts. For example, in Germany, when a seller makes a non-conforming tender, it seems that a buyer may reject the goods or make a price adjustment for the non-conformity.

9.10 Questions for Review

CHAPTER 9 -- QUESTIONS FOR REVIEW

1. What is a discharge of duties?

2. What are the differences between promises and conditions?

3. Why should parties consider putting conditions in their contracts?

4. What are the differences among conditions precedent, subsequent and concurrent?

5. What are the differences among conditions that are express, implied-in-fact and implied-in-law?

6. What is a forfeiture?

7. Describe three types of situations where implied-in-law conditions may exist.

8. In general, what will cause conditions to occur?

9. When can complete performance fulfill a condition?

10. When can substantial performance fulfill a condition?

11. What is a breach of a contract?

12. How can courts determine if substantial performance has occurred?

13. What is an anticipatory repudiation?

14. What is prospective inability or unwillingness to perform?

15. How can the failure or occurrence of one condition excuse another condition?

16. How can rejection of a tender of performance excuse a condition?

17. How can prevention or hindrance excuse a condition?

18. What is a waiver and how can it excuse conditions?

19. What are some differences between waiver before a condition is to occur and waiver after a condition fails to occur?

20. What is estoppel and how can it excuse conditions?

21. How can impossibility excuse conditions?

22. How does severability affect conditions?

23. What are some limits on conditions of approval by parties to a contract?

24. What are some limits on conditions of approval by non-parties?

25. Describe a special problem that may occur in the performance of construction contracts.

26. Give examples of special rules about waiver in sale of goods contracts.

27. Describe some of the rules explained in this Chapter about tender of goods in single lot contracts.

28. Describe some of the rules explained in this Chapter about tender of goods in installment contracts.

29. Give examples of how the duty of good faith and fair dealing may affect contract performance.

30. What is the effect of complete performance on contract duties?

31. How can a breach discharge contract duties?

32. How can an anticipatory repudiation discharge contract duties?

33. How can a rejection of a tender discharge contract duties?

34. How can the occurrence of a condition subsequent discharge contract duties?

35. How can avoidance of a voidable contract discharge contract duties?

36. What is mutual rescission and how can it discharge contract duties?

37. What is a release and how can it discharge contract duties?

38. What is a substitute contract and how can it discharge contract duties?

39. What is an accord and satisfaction and how can it discharge contract duties?

40. What is a novation and how can it discharge contract duties?

41. What is an account stated and how can it discharge contract duties?

42. How can impossibility or impracticability discharge contract duties?

43. What are some important situations where impracticability may discharge contract duties?

44. How can frustration of purpose discharge contract duties?

45. How can bankruptcy proceedings discharge contract duties?

46. How can a court judgment or arbitration award discharge contract duties?

47. How can the passage of the time set by a statute of limitations discharge contract duties?

48. How does the Cambodian legal approach to contract performance compare to the approach discussed in this Chapter?

49. How does the civil law approach to contract performance compare to the one discussed in this Chapter?

CHAPTER TEN

REMEDIES

10.1 Introduction

This text has discussed when contracts are enforceable (Chapters 1-7), how courts interpret what contracts mean (Chapter 8), and how courts analyze the performance of contracts (Chapter 9). It is now time to explain what courts resolving a contract dispute might actually do if they decide that some court action is appropriate in order to achieve justice, and what they might allow the parties to do, in order to give effect to the ideas discussed in Chapters 1-9. The options courts and parties have if they do decide to act in response to a legal problem are called remedies.

When there is a contract dispute or problem, the law gives courts and parties a number of potential remedies. It also provides many guidelines for when the remedies can be used. Of course, a court may decide that it should take no action at all in response to a contract dispute! That would be the proper response if a court finds that the claim or claims brought to it have no merit. But if the court decides that a claim about which it is deciding does have merit, and that some action is appropriate, then there are a number of things the court may do. What action is appropriate depends on the situation.

This Section will try to provide a general overview of the types of remedies courts may order or allow, and of some important limits on the power of the courts to order remedies. The two main groups of remedies available to a court deciding a contract dispute are:

(1) money damages, and

(2) non-monetary remedies.

Probably the most common type of remedy that common law courts deciding contract disputes order is money damages.

*** **DEFINITION: Money damages** is an amount of money that a court or arbitrator orders one party to a legal dispute to pay to another party to the dispute because of some injury or loss the first party caused to the second party.

In contract disputes, money damages are generally designed to compensate injured parties for the harm they have suffered. They are not usually intended to penalize parties. And there are a number of different types of money damages a court may order.

Probably the damages remedy that is most often appropriate is expectation damages. These are damages which try to put the injured party in the position she would have occupied if parties had properly performed the contract or promise in dispute. The goal of expectation damages is to try to give the injured party the "benefit of her bargain." Expectation damages are discussed in Section 10.2, below.

If expectation damages are not appropriate, courts may instead order reliance damages. These are damages that try to put the injured party back in the position she occupied before a contract or promise was made. Reliance damages are discussed in Section 10.3.

In appropriate situations, courts may choose to order that a party pay restitution damages. Restitution, as discussed in previous Chapters, tries to compensate the injured party for the value of a benefit she has given to another party, in order to prevent unjust enrichment. It is often used in quasi-contract situations. Restitution damages are discussed in Section 10.4.

Although the three types of damages described above are the most common, courts may choose to order other types of damages in particular situations. Courts may order a party to pay stipulated (liquidated) damages where the contract itself describes the damages to be paid for a breach, although there are limits on courts' ability to enforce such contract terms. Courts may order a party to pay nominal damages where a breach has occurred but no real harm has been proved. Courts in many jurisdictions will also order a party to pay interest on the damages from the time of the court's judgment until the judgment is paid. And courts may in certain situations even order parties to pay interest on the damages from the time of a breach! But courts deciding contract disputes--especially in common law jurisdictions--generally do not order that a party pay punitive damages because of a contract problem. Punitive damages are designed to punish parties for misconduct, rather than compensate the injured party for damage done to her. These other types of damages are discussed in Section 10.5.

There are several important general limits on the ability of courts to order parties to pay money damages to other parties where there is a contract dispute. These limits are designed to ensure that courts generally do no more than fairly compensate injured parties for the harm they have suffered. First, parties may generally recover only damages that they prove to the court with reasonable certainty. Second, parties can generally recover only damages that a reasonable person could have foreseen. Third, parties cannot recover damages that they could reasonably have avoided. These important limits may result in a big reduction in the amount of damages a party may recover--

or even result in the party not receiving any damages at all! These limits are discussed in Section 10.6

Courts may also order or allow non-monetary remedies in appropriate situations. That is, courts may order or allow parties to do things that do not involve paying damages to the other party to the dispute. First, courts may order specific performance of a contract, which means ordering a party to actually perform as she promised in the contract. This appears to be a common remedy in civil law jurisdictions. However, many common law jurisdictions only use this remedy in the limited situation where damages are inadequate and the courts believe they can adequately enforce the order. This generally occurs only in contracts for the sale of land or unique goods. Courts may also order rescission, which basically means canceling the contract and providing the parties with restitution. Courts may order reformation or severance of a contract, which generally means enforcing a contract without some part that cannot be enforced because of a formation problem. And other non-monetary remedies may be available to courts and parties in particular situations, such as specific restitution (the return of the actual benefit given to a party); remedies specified in the contract itself; or the withholding of a performance because of the failure of a condition. These remedies are discussed in Section 10.7.

Remedies vary depending on the type of contract involved and the situation of the parties. Most particular situations cannot be fully discussed here, and it is important to check the local law to find out exactly which remedies courts in a jurisdiction may use in a certain type of situation. However, this Chapter will briefly examine which remedies may be available in disputes about sale of goods contracts, where courts find a quasi-contract, and where courts apply the doctrine of promissory estoppel (detrimental reliance). These types of remedies are discussed in Section 10.8.

Before this text discusses the potential remedies noted above, it is important to understand two essential limits on the ability of courts to act in contract disputes in free market jurisdictions. First, in free market jurisdictions, contract disputes are civil matters--not criminal matters. Courts have no power to impose criminal penalties in contract disputes.

Of course, if parties have also committed a separate crime in connection with a contract, they may be prosecuted for that crime. For example, if a party makes a contract to rob a bank and then robs the bank, the party may be prosecuted under the criminal statute that prohibits robbing banks. If a party commits criminal fraud, and the party happens to use contracts to commit that fraud, the party may be prosecuted under the criminal statute that prohibits fraud. And there are certain carefully defined criminal statutes, such as prostitution laws or trade laws, that may impose criminal penalties for making certain illegal contracts whose performance may threaten the safety or basic well-being of society. But parties in such cases are not prosecuted for making contracts. They are prosecuted for violating carefully defined

criminal statutes. It is generally not a crime to make an unenforceable agreement. And it is never a crime to breach a contract.

The second important limit on courts' ability to act in contract disputes is not really a limit that the law imposes, but a problem that the law cannot completely solve. In reality, where there is a contract dispute, the law often cannot fully compensate the parties for the harm caused by the contract problem involved, and by the dispute about the problem. Even if a court or arbitrator orders one party to pay damages to another party because of a breach of contract, the law can never fully compensate an injured party for the time that party has spent dealing with the problem and the legal action. This is time the party could have spent being productive in her work, or pursuing other worthwhile activities. Legal problems take that time away, and it cannot really be recovered. In addition, while some jurisdictions say that the losing party in a civil lawsuit must generally pay the attorneys' fees of the winning party, other jurisdictions generally say that each party must pay her own attorney, no matter who wins the dispute. So in those jurisdictions, that money cannot be recovered. And no one can truly compensate a party for the mental stress that may be caused by a legal problem and by litigation--which can seem like a war fought with words and paper! The fact is that the law cannot solve all problems. As noted in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.1c, law is only a basic tool that is generally more useful and fair than the alternative ways to resolve disputes, such as violence.

This limit on the ability of law to fully resolve contract disputes means that it is often a good idea to try to resolve contract disputes in a less adversarial way, and without the use of the courts. As also discussed in Chapter 1, Section 1.1c, alternative dispute resolution ("ADR") may reduce the effect of some of the problems discussed above. Important forms of ADR include negotiation, conciliation, mediation, and arbitration. But ADR can rarely solve such problems completely. In addition, ADR may not be possible in some situations, such as where one party is very stubborn. And it is not always a good idea. For example, ADR may not be appropriate where one party has much more power than the other party, and the powerful party refuses to reach a fair solution to the problem without the involvement of a court. Even so, ADR is usually worth considering for contract disputes.

*** ***WHY IS THIS IMPORTANT?*** Why do the laws of free market jurisdictions say that criminal penalties are not generally possible in contract disputes?

The reason for this limit is that the law provides different remedies for different problems. Some problems are more serious than others, and some are simply different from others. So the law tries to provide a remedy that is fair and appropriate for the particular problem it is trying to solve. Of course, this is not always easy, and the law is not always successful.

The law does not generally view breaching a contract, or simply making an unenforceable contract, as causing such serious harm to society that it justifies depriving a person of her liberty or imposing criminal fines. In fact, most jurisdictions do not generally view such actions as being a moral wrong that is even serious enough to justify punitive damages! Of course, contracts are important, and contract disputes are important. But in free market jurisdictions, persons may face the kinds of penalties described above only for serious moral wrongs that actually threaten the safety or basic well-being of society. It appears that contract disputes rarely meet that standard. The law in most jurisdictions (particularly common law jurisdictions) says that contract remedies are generally designed to compensate the party harmed for the actual harm caused to her, rather than to punish the other party.

In fact, breaches of contract are not always viewed as very wrong at all. Some authorities say that, in certain situations, it may actually be better for parties to breach contracts if that will achieve greater economic efficiency and prosperity, and if that can be done without undue permanent harm to the injured party. For example, it might be argued that it would be better for a party to breach a contract and pay damages, if that would actually be more economically efficient overall than performing the contract. This might be the case because the breaching party can be more productive by performing a contract with a different party.

Of course, this view may seem unfair to parties injured by contract problems. As discussed above, it may not be possible to compensate such parties fully for the harm done to them. More contract breaches might also lead to a loss of faith in contracts. In fact, sometimes such breaches may even be considered "bad faith," which can actually be a tort in certain situations, as explained in Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c, and Section 10.5d below. Perhaps the harm caused by breaches of contracts is too high a price to pay for some apparent increase in economic efficiency.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.1c discusses the limits of the law and alternative dispute resolution, and Section 1.4i contains a more concise discussion of remedies; and Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c explains how bad faith breaches of contracts can actually be torts in certain situations.

10.2 Courts Often Order a Party to Pay Expectation Damages, Which Try to Put an Injured Party in the Position She Would Have Occupied If the Parties Had Fully Performed the Contract

In general, when there is a breach of a contract, many courts try to put the injured party in the position she would have occupied if the parties had fully performed the contract. In other words, courts try to measure the difference between what should have happened (complete performance) and what actually did happen (less than complete performance). They try

to determine the amount of money that will reflect this difference as closely as possible. Then they order the breaching party to pay the non-breaching party this amount of money. This amount is called the expectation damages.

*** **DEFINITION: Expectation damages** are damages that try to place a party injured by a contract breach as close as possible to the position she would have occupied if the parties had fully performed the contract.

Expectation damages is the damages remedy that is probably chosen most often by courts where there is a breach of contract. This is because it generally comes closest to giving the injured party the "benefit of her bargain." In fact, in most situations, common law courts first see if they can fairly award expectation damages. In these cases, such courts generally consider other potential remedies only if expectation damages cannot be awarded. Expectation damages cannot be awarded in every case, because of the limits on the award of damages, as will be explained later in this Section and in Section 10.6, below.

For example, suppose Samean and Vipheap make a contract under which Samean agrees to sell Vipheap a number of tables for $1,000. If Samean delivers all the tables according to the contract, but Vipheap fails to pay any money for them, Vipheap has breached the contract. In this situation, the difference between what should have happened--Vipheap paid Samean $1,000 and received all the tables--and what actually did happen--Vipheap paid $0 and received all the tables--is $1,000. This is because $1,000 minus $0 is $1,000. These are the expectation damages--the amount needed to put Samean in the position he would have occupied if the contract had been fully performed. These are the damages most courts would award in this situation.

10.2a How to Calculate Expectation Damages

Not all cases are as simple as the example above. So many jurisdictions have developed a two-step process to help courts determine expectation damages in a variety of cases. In this process, these courts determine:

(1) the value in money of the additional benefits the injured party would have received if the breaching party had fully performed;

and (2) the value in money of how much the injured party saved (if any) because she was not required to perform her own duties under the contract.

To find the expectation damages, courts take the first number (the expected additional benefits), then subtract the second number (the amount saved, if any). The result is the expectation damages.

The second number above will take account of any other damages to the injured party that a court believes should be paid by the breaching party. These would include incidental damages for money the injured party had to

spend to find another party with whom to make a new contract to take the place of the old one. Of course, that kind of damages will actually reduce the second number, since it will reduce the amount that the injured party saved by not having to perform the breached contract.

For instance, in the table example above, the value of the additional benefits Samean expected was $1,000, since the contract required Vipheap to pay him $1,000, and Vipheap had paid $0 of this amount. The amount Samean saved was $0, since he actually did fully perform by providing all the tables under the contract. In this case, $1,000 minus $0 = $1,000. So $1,000 is the expectation damages.

However, if Vipheap had actually paid some of the money to Samean, then the result would be different. Suppose Vipheap had paid Samean $300. The court would first find the value of the additional benefits Samean expected. That would be $1,000 minus the $300 Vipheap paid, or $700. Then the court would find how much Samean saved by not having to fully perform. This amount is still $0, since Samean did fully perform. So the expectation damages in this situation are $700 minus $0 = $700. The court would order Vipheap to pay $700 to Samean.

The process of calculating expectation damages will also differ where the court must calculate the value of a performance other than money. This will happen whenever a party whose performance is not the payment of money does not fully perform. This could occur because that party breaches, or because the other party breaches. The examples above were simple, because the party whose performance was not the payment of money (Samean) fully performed, by delivering the tables. But in other cases, the court will have to determine the value of a non-money performance that has not occurred. This may be necessary in order to determine the amount of additional benefits the non-breaching party expected, or the amount that party saved by not having to complete her performance. For instance, in the table example, this would occur if Samean did not deliver all of the tables, perhaps because Vipheap repudiated. In this kind of situation, it will be more complex for the court to determine how much a non-breaching party like Samean saved by not having to perform. This is because her savings are that part of the performance that she has not provided to the breaching party.

Different courts have different ways of calculating the value of a non-money performance. There are at least three different ways to do so. These ways are described below.

(1) Market Value at Time Non-Breaching Party Learned of Breach -- It appears that many courts generally use the market value at the time the non-breaching party learned of the breach to calculate the value of a non-money performance. In the table example, that would be the market value of Samean's performance (providing the tables) when Samean learned of

Vipheap's breach. That time might actually be before the time that performance was due, in the case of a repudiation.

(2) Market Value at Time Performance Due -- Some other courts use the market value at the time the performance being valued was due. In the table example, that would be the value of Samean's performance at the time it was due. This would seem to be a fairly accurate way to measure the damage to a party like Samean.

(3) Actual Value of Substitute Performance Non-Breaching Party Reasonably Finds -- Finally, some courts use the value of what the non-breaching party actually received when she reasonably found another performance to take the place of the breaching party's performance. In the table example where Samean did not deliver all the tables because of Vipheap's breach, this would be the amount Samean actually received when she re-sold the tables to someone else after the breach. Finding a substitute performance in this way is very common, since the non-breaching party can only recover damages she could not reasonably have avoided. A court will not award her money for damages she caused herself unnecessarily in order to punish the breaching party! This limit on damages will be further discussed in Section 10.6c, below.

Some jurisdictions have different rules about this problem for different kinds of contracts. For example, the Uniform Commercial Code ("UCC") in the United States says that, for sale of goods contracts, courts should use the third method (the actual substitute performance price) if a non-breaching party actually does find a substitute performance; the second method (the market value at the time performance was due) for a non-breaching seller who does not find a substitute performance; and the first method (the market price at the time the non-breaching party learns of the breach) for a non-breaching buyer who does not find a substitute performance. In fact, this split method may come closest to measuring the actual harm to the non-breaching party. Remedies in sale of goods contracts will be further discussed in Section 10.8a, below.

In order to see how these three different methods work, consider the table example above. Suppose Vipheap made an anticipatory repudiation of the contract one week before Samean was scheduled to provide the tables, Samean chose to treat this as a material breach, and Samean did not perform. So neither party performed at all. In that case, the court would first find the value of the additional benefits Samean expected. That amount would still be $1,000 minus the $0 Vipheap paid, or $1,000.

Then the court would determine how much Samean saved by not having to fully perform. Under the first method described above, the court would use the market value at the time Samean learned of the breach in order to determine how much Samean saved. Suppose that value was $850. In fact, a market value lower than the contract price is one reason a buyer like Vipheap

might repudiate a contract like this. The reason is that, in that situation, Vipheap could have found someone else to supply the tables at a price that was lower than the price in his contract with Samean. Suppose also that Samean does not find a substitute performance. In that case, Samean would have saved the $850 the tables were worth at the time he learned of the breach. Samean's expectation damages would be the $1,000 in additional benefits he expected, minus the $850 he saved by not having to perform, which is $150. The court would award him $150 ($1,000-$850).

Under the second method described above, the court would use the market value at the time performance was scheduled to occur in order to determine how much Samean saved. Suppose that value was $925. Suppose also that Samean reasonably spends $50 in trying to find a substitute performance, but that he fails to find one. In that case, Samean would have saved the $925 the tables were worth at the time he was scheduled to deliver them, minus the $50 in additional damages caused to him by Vipheap's breach. So he would have saved $875 ($925-$50). Samean's expectation damages would be the $1,000 in additional benefits he expected, minus the $875 he saved by not having to perform, which is $125. The court would award him $125 ($1,000-$875). This is the method the UCC would use in this situation.

Under the third method described above, the court would use the actual value of the performance Samean reasonably found to take the place of Vipheap's performance in order to determine how much Samean saved. Suppose Samean managed to re-sell the tables for $975, and that was a reasonable price considering all the circumstances. Suppose also that Samean still had to spend $50 to find the new buyer. In that case, Samean would have saved the $975 he actually received when he re-sold the tables, minus the $50 in additional damages caused to him by Vipheap's breach. So he would have saved $925 ($975-$50). Samean's expectation damages would be the $1,000 in additional benefits he expected, minus the $925 he saved by not having to perform the original contract, which is $75. The court would award him $75 ($1,000-$925). This is the method the UCC would use in this situation.

As you can see, these three methods can lead to different results, depending on the facts of the case. In particular, the first method may not seem like a very accurate way to measure the real harm to a non-breaching party like Samean. This is because Samean's real damage would seem to depend on what happens to him as a result of the breach, not simply the value of his performance at the time he learns of the breach. The second and third methods would seem to be better ways to measure the harm to Samean in the situations where they would be applied. But the first method might be useful where it is hard to calculate the value of the performance of the non-breaching party at any other time. This might occur where the court must decide the case before the performance was actually scheduled to occur, or the performance was not scheduled to occur at a very specific time, and where the party has found no reasonable substitute performance.

On the whole, if the non-breaching party does act reasonably to find another performance to take the place of the breaching party's performance, the third method would appear to be the easiest and most accurate way to measure her actual expectation damages. Of course, as will be discussed further in Section 10.6c, the non-breaching party cannot recover damages she could reasonably have avoided. Parties take risks if they do not find a substitute performance, including the risk that a court will not determine the real value of the performance in a way that is favorable to them, and the risk that they will suffer damages they cannot recover in court. They may also have to spend time and effort arguing about what the performance was worth. And they may have to wait some time for a court case to be resolved. Many parties wish to avoid these risks and problems. So they often find substitute performances. This third method to measure damages is used in Example 3 in the following Illustration.

Illustration: How to Calculate Expectation Damages

STEPS	**EXAMPLES (Samean and Vipheap)**		
	Example 1	**Example 2**	**Example 3**
Step 1: What happened?	Samean delivers tables, Vipheap fails to pay the $1,000 the contract requires	Samean delivers tables, Vipheap fails to pay $700 of the $1,000 the contract requires	Vipheap repudiates, Samean does not deliver tables; neither party performs; Samean reasonably re-sells tables for $975, and has $50 in extra expenses
Step 2: How much more would injured party have received if contract fully performed?	$1,000	$700 ($1,000 minus the $300 Vipheap paid)	$1,000
Step 3: How much did injured party save because she did not have to perform her own duties?	$0	$0	$925 (the $975 re-sale price of the tables minus the $50 additional damage to Samean)
Step 4: What is the difference between the amounts in Steps 1 and 2? This is the EXPECTATION DAMAGES	**$1,000** ($1,000-$0)	**$700** ($700-$0)	**$75** ($1,000-$925)

It is also possible that courts may use a combination of more than one of the above methods of valuing non-money performances. This might occur where a party finds a substitute performance for only part of the performance

she expected to receive from the breaching party. Consider the following Case Study.

*** ***CASE STUDY 228***

FACTS A professional home builder named Oun makes a contract with Marady. Under the contract, Oun agrees to build a big new house for Marady on a lot Marady owns. The total price for the work is to be $70,000. The work is to be completed in six months. Marady agrees to pay Oun $10,000 right way, and $10,000 at the end of each month until the work is completed. These monthly payments are conditioned on Oun making satisfactory progress, and Oun's continuation of the work is conditioned on Marady making these payments on time.

Marady pays Oun $10,000. Oun makes all the arrangements for building materials, equipment and a work crew, and Oun's crew works on the house for one month. However, at the end of the first month, Marady fails to make the next payment. When Oun asks Marady why, Marady says he has lost all his money at the casino, and that he will be unable to pay any more money.

Oun tells Marady that he is stopping performance, as the contract allows. Oun does his best to reasonably compensate his workers, return the equipment he has rented, and sell the materials he has purchased, or use them in some other way on other jobs. However, he cannot get refunds for some of the equipment he has rented, and he is unable to sell or use some of the materials he has purchased. Paying for all of this costs Oun $10,000. Oun had reasonably estimated that the entire job would cost him $50,000 to perform.

Oun tells Marady about the money he has had to pay as a result of Marady's breach. Oun says he wants to be compensated so that he is in the position he would have occupied if Marady had fully performed. However, Marady says that the $10,000 he already paid was enough to cover Oun's expenses, so he should not be required to pay any more. Oun tries to reach some agreement with Marady to resolve the problem, but when this fails, he asks the court for help.

QUESTION OF LAW Can Oun recover further damages for Marady's breach of this contract?

DECISION Yes. Oun will likely be able to recover his expectation damages because of Marady's breach of this contract. In this case these damages will probably be about $20,000, assuming Oun provides sufficient proof of what it would have cost him to finish building the house and what it cost him to react to Marady's breach.

In general, when many courts award damages because of a contract breach, they try to order the breaching party to pay expectation damages,

in order to put the injured party as close as possible to the position she expected to occupy after the parties had fully performed the contract. These damages can be calculated by determining how much more the injured party would have received if the parties fully performed the contract, and subtracting any amount that party saved by not having to perform the rest of the contract.

In this case, Marady breached a contract under which Oun was to build him a new house. Oun would have received $60,000 more in additional benefits if Marady had fully performed. This is because Oun had received only $10,000 of the $70,000 contract price. Oun's savings because he did not have to finish his performance were about $40,000. This is because he had to spend $10,000 of the total of $50,000 he planned to spend to build the house in order to pay for the first month's work and otherwise react to Marady's breach. So in this case, Oun's expectation damages are the $60,000 in additional benefits he expected to receive, minus the $40,000 he saved because he did not have to perform fully. So his expectation damages are $20,000 ($60,000-$40,000). Assuming Oun provided adequate proof of the above costs, the court would order Marady to pay Oun $20,000.

In the Case Study above, the court in calculating the savings to Oun actually used a combination of the methods discussed above. The court had to find the value of the non-money performance that Oun did not have to provide to Marady because of Marady's breach. In making this calculation, the court used the amounts that Oun actually received by selling some of the materials he had planned to use (which is basically a substitute performance). But the court also used market values, such as the estimated market value of the total amount it would have cost Oun to finish building the house ($50,000). It appears that which market value the court uses (the value at the time of performance or at the time the non-breaching party learned of the breach) will depend on the court and the circumstances of the case. The basic idea is to come as close as possible to finding the value of the performance Oun was not required to provide.

In some situations, the value of a non-money performance may actually be less than 0! This could occur where the non-money performance a party provides actually causes more harm than benefit. For example, in the Case Study 228 situation, suppose Marady made all payments and did not breach. However, Oun did breach by building a defective house--a house so defective that it could not be repaired, but had to be torn down. So construction had to begin again. In that situation, a court might say that the additional benefits Marady expected to receive would be not only the cost to have the house built correctly, but also the amount it would cost to have the defective house torn down. Suppose it costs Marady $10,000 to have the defective house torn down, and $75,000 to have the new house built. Altogether, the cost of the additional benefits Marady expected would be $85,000. The amount Marady saved by not having to perform fully would be $0, since he did perform fully. So the expectation damages would be $85,000 minus $0. The court would award

Marady $85,000. It would take $85,000 to put Marady in the position he expected to occupy after the contract was performed.

10.2b Limits on Expectation Damages

As noted above, there are some limits on the ability of courts to award expectation damages. These limits may result in a court being unable to award these damages, and they may force the court to choose a different type of remedy. Or they may simply result in a court calculating the damages in a different way.

The ability of courts to order expectation damages is subject to the important general limits that such damages must be reasonably certain and reasonably foreseeable, and that the party seeking to recover could not reasonably have avoided the damages. These three important limits will be discussed in more detail in Section 10.6 below, but some are especially important in considering expectation damages.

First, the amount of expectation damages must be reasonably certain. If that amount is too speculative, courts will refuse to award such damages, and may select reliance damages instead. Speculative damages may be a problem in cases involving lost profits, especially those involving new businesses such as restaurants. For example, a party who is injured by a contract breach in trying to open a new business in a field in which she has never worked may be unable to recover damages for lost future profits. This is because the amount of such potential profits might be too uncertain. On the other hand, a party in a new business situation might still be able to get expectation damages if she can persuade a court to use estimates based on similar businesses she ran in the past, or other similar ventures. This limit will be discussed in more detail in Sections 10.3 and 10.6a, below.

Another general limit that can be especially important in cases involving expectation damages is that such damages must have been reasonably foreseeable at the time the contract was made. The non-breaching party generally cannot recover damages the breaching party could not reasonably have foreseen. For example, suppose a shoe repair shop breaches a repair contract by failing to deliver a pair of shoes to a person on time. Suppose one result of that breach is that the shoe owner cannot interview for and get a new job because she has no shoes to wear. Such damage might be beyond what the repair shop could have reasonably foreseen. This limit will be discussed in more detail in Section 10.6b, below.

Another important limit on expectation damages occurs where the amount it would take to put the injured party in the exact position she expected to be in is clearly far greater than the real loss in value to the injured party. Sometimes it would cost much more to put the injured party in the exact position she expected to occupy--to actually fix the problem caused by the breach--than it would to simply compensate the injured party for the difference

in value between what she expected and what she received. Many courts say that if the cost of actually fixing the problem caused by the breach is clearly far greater than the real loss in value caused by the breach, then the injured party cannot generally recover the amount required to actually fix the problem. The reason is that to award such damages in that situation would be economically wasteful. In that case, the injured party would probably receive only the amount of the loss in value caused by the breach. The court is still ordering that the breaching party put the injured party in a position that is basically as good as the position she expected to be in.

The two-step process explained in Section 10.2a appears to account for this "loss in value" problem. That process focuses on the value in money of the additional benefits the non-breaching party expected to receive--not on what it would cost to put that party in exactly the position she expected to occupy.

*** ***CASE STUDY 229***

FACTS Suppose the story in Case Study 228 happens a different way. Suppose Oun builds the house, and Marady pays the contract price. Oun performs according to the contract, except that he puts one of the pillars inside the house in the wrong place. The result of this breach is that part of the interior of the house is less attractive. As a result, the house is worth $200 less than it would have been if Oun had put the pillar in the right place. However, because the pillar supports important parts of the house, it would actually cost $10,000 to remove the pillar and put it in the correct place.

Oun admits his mistake, and offers to pay Marady the $200 loss in value to house. But Marady is very angry. He demands the full $10,000 it would take to get the pillar in the right place--to put him in the exact position he expected to be in.

QUESTION OF LAW Can Marady recover the $10,000 it would take to actually fix the problem of the pillar?

DECISION Probably not. The amount it would take to actually fix this problem ($10,000) is clearly far greater than the loss in value caused by the breach ($200), so Marady's damages will probably be limited to $200.

Where the amount required to actually fix a contract breach--to actually put the injured party in the exact position she expected to occupy--is clearly far greater than the actual loss in value to the injured party, many courts will limit the damages to the loss in value.

In this case, Oun breached the contract by failing to put a pillar in the proper place in the house he built for Marady. This caused part of the house to be less attractive. The actual difference in value of the house was about $200, but the amount it would have taken to actually move the pillar was $10,000.

This is clearly far greater than the real loss involved here. So many courts would limit Marady's recovery to $200.

A variation of this rule seems to occur where the damages caused by a breach are extremely large in relation to the contract price. For example, suppose a party breaches a contract to fix a restaurant generator for $10 just before a busy weekend, perhaps by failing to come to fix the machine at all. Because the restaurant has no working generator that weekend, it loses $300 in business. Some courts would say that the restaurant could not recover the full $300 it lost, even though that damage was reasonably foreseeable. The reason seems to be that some courts believe that parties often do not expect that damages of that size will result from a breach of a $10 repair contract. Or perhaps courts believe that it is simply not fair to hold the repairer liable in that situation. Of course, the restaurant could recover other kinds of damages, if it had suffered any. These issues will be further discussed in Section 10.6b, below, on foreseeability.

One apparent exception to the "clearly far greater than" rule occurs where the parties knew that the performance involved very personal or special elements. For example, suppose a party makes a contract to have a large statue of herself built in front of her house. However, the builder creates a statue of a famous monarch instead! In that case, the cost to fix the problem would probably be very high, since the old statue would have to be removed and a new one built. But there might actually be no loss in value, since the statue of the monarch might be more valuable than that of the owner. Even so, a court might award the cost to actually fix the problem. This is because the parties probably understood that the real reason for the contract was very personal, and was not simply to create a valuable statue.

10.3 Courts May Order a Party to Pay Reliance Damages, Which Try to Put an Injured Party in the Position She Occupied Before a Contract or Promise Was Made

As noted above, reliance damages try to put the injured party in the position she occupied before a contract or promise was made. That is, they try to compensate the injured party for the amount she has lost by reasonably relying on the contract or promise. Reliance damages may include compensation for money or other consideration that the injured party gave to the breaching party, such as services. But they may also include compensation for things that the injured party did not give to the breaching party, but that the injured party spent otherwise in reasonable reliance.

*** **DEFINITION: Reliance damages** are damages that try to place a party injured by a contract breach or failure to perform a promise as close as possible to the position she occupied before the contract or promise was made.

Reliance damages are often awarded where expectation damages are not appropriate in a particular contract dispute. For example, where a contract is breached, expectation damages are sometimes too uncertain or too difficult to prove. This often occurs where lost profits are too difficult to measure. Expectation damages may also be inappropriate for other reasons, such as where there is no enforceable contract, but the court applies the doctrine of promissory estoppel (detrimental reliance). In these types of situations, courts may order one party to pay another party reliance damages.

Reliance damages may be especially useful where expectation damages are hard to calculate. In particular, this may occur with contracts that relate to new businesses. Where there is a breach involving the formation of a new business, it can be very difficult to determine and prove with reasonable certainty what position a party would have occupied if the parties had fully performed the contract. This is because the business involved in the contract is a new one that has not even opened yet! Of course, as discussed in Section 10.2 above, a party in a new business situation might still be able to get expectation damages if she could persuade a court to use estimates based on similar businesses she ran in the past, or other similar ventures. But that can often be difficult. The requirement that damages be proved with reasonable certainty will be further discussed in Section 10.6a, below.

In any case, parties can often prove reliance damages much more easily than expectation damages. That is because those damages are based on things the parties have already done, and for which they often have receipts or other strong proof. And of course, such damages are generally available whether any of the money or other consideration transferred actually went to the breaching party or not.

One area in which expectation damages may be hard to calculate, and reliance damages may be more appropriate, is when a contract breach relates to the opening of a new restaurant. Consider the following Case Study.

******* ***CASE STUDY 230***

FACTS Chan and Yutho had little experience in the restaurant business. But they made a contract to start a big new chicken restaurant together. The restaurant's specialty was to be young chickens. As part of the contract, each party agreed to buy certain equipment and supplies, to negotiate with suppliers, and to hire and train staff, in order to get ready for the restaurant to open. In the weeks before the opening date, Yutho spent $2,000 on equipment and supplies, and in negotiating with suppliers. Unfortunately, two weeks before the restaurant was scheduled to open, Chan breached the contract and refused to perform.

Yutho asked Chan to compensate her for the lost profits the restaurant would have made. Chan refused, saying there was no way to calculate those

profits. Chan said Yutho had not actually given him anything, so he owed her nothing. Now Yutho asks the court for help.

QUESTION OF LAW Can Yutho recover expectation damages because of the breach of the restaurant contract by Chan?

DECISION Probably not, because those are likely to be too uncertain, but she probably will be able to recover her reliance damages for the money she spent preparing to open the restaurant.

Where a breach of contract involves the formation of a new business, expectation damages may be difficult to calculate with reasonable certainty, since it may be hard to show how much money the new business would have made. In those situations, reliance damages may be more appropriate.

In this case, Chan breached a contract with Yutho to open a new chicken restaurant. Yutho wants expectation damages. But she may have trouble proving them with reasonable certainty, particularly since she does not have substantial experience in the restaurant business. In addition, the restaurant business is especially risky and hard to predict. Many new restaurants lose money for some time, and many actually fail and close down. So it would be very difficult to say with reasonable certainty how much money the new restaurant would have made.

The court would be much more likely to award Yutho reliance damages. These would be the $2,000 she spent on equipment and supplies in reasonable reliance on the contract, getting ready for the restaurant to open. She should be able to prove these damages to the court much more easily, especially if she has receipts for the items she has purchased. And she can get these damages even though none of the money she spent actually went to Chan.

Another situation where courts may use reliance damages is construction contracts. For example, suppose Sem makes a contract to build a new office building for Ear for $1,000,000. Sem spends about $20,000 on materials, machine rentals, and labor. Then Sem starts work. But Ear soon makes an anticipatory repudiation. In this situation, Sem could try to prove expectation damages. He will have to show what he will save by not having to finish the construction. If he can show that, then he may be able to recover the difference between that amount and $1,000,000. However, in some cases like this, which involve large, complex projects, it might be difficult to prove with reasonable certainty how much it would have cost to finish the construction. Sem might actually spend a lot of time and money simply trying to prove this to the court!

In this situation, Sem might choose to ask the court for his reliance damages. Those damages would basically be the amount he reasonably spent in preparing to perform and actually performing up until the time Ear breached. Of course, this amount might not be as much as the expectation

damages. But it might be better to recover this than to spend a lot of time and money trying to prove expectation damages--and risk failing to do so well enough to recover the damages at all.

Promissory estoppel (detrimental reliance) is another important area where courts may order reliance damages. Promissory estoppel was already discussed in detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.8. The doctrine basically says that a promise is enforceable, even though there is no valid contract, where a party has acted in justifiable reliance on it and it would be unjust not to enforce the promise. Obviously, reliance damages are essential to promissory estoppel, since the doctrine was intended to resolve the problems created by reasonable reliance.

For example, in Case Study 176, Ken relied on Margo's promise to give him a job in Battambang. Although the promise was probably too indefinite to form a valid contract, a court might find that Ken was justified in relying on it. If a court found that, it would be unlikely to award Ken expectation damages, as those would probably be too uncertain. But the court would be likely to award Ken reliance damages. That would be the amount he spent in quitting his old job, selling his house, and moving to Battambang. Suppose that amount was $1,000.

Illustration: How to Calculate Reliance Damages

STEPS	**EXAMPLES**		
	Example 1 (Case Study 230 (restaurant))	**Example 2 (Office construction)**	**Example 3 (Case Study 176 (Ken's job))**
Step 1: What happened?	Yutho spends $2,000 in reliance, Chan breaches, Yutho has trouble proving expectation damages	Sem spends $20,000 in reliance, Ear repudiates, Sem has trouble proving expectation damages	Ken justifiably relies on Margo's job promise, spends $1,000 in reliance, Margo says there is no job
Step 2: How much has the injured party lost because of reasonable reliance on the contract or promise? This amount is the RELIANCE DAMAGES	$2,000	$20,000	$1,000

There are several important limits on the reliance damages parties may recover. The three general limits described in Section 10.2--that damages be reasonably certain and reasonably foreseeable, and that the party seeking to recover could not reasonably have avoided them--also apply to reliance damages. These general limits will be further discussed in Section 10.6, below.

Another important limit on reliance damages in many jurisdictions is that the injured party cannot recover reliance damages that are any greater than her expectation damages. The reason for this limit is that courts generally do not wish to order that parties receive more than they even expected to receive under the contract! If the "injured" party would have made no money on the contract, she may be unable to recover reliance damages.

For example, in the construction example above, suppose Ear can prove that Sem would have actually lost $50,000 on the contract, perhaps because Sem had misjudged how much effort some part of the work would take. In other words, the project would have cost Sem $1,050,000 to complete--even though he was only being paid $1,000,000 for the work! Suppose also that Sem had spent $20,000 on the project before Ear breached. So the reliance damages would be $20,000. If there is no evidence in court about what the expectation damages were, Sem could probably recover those reliance damages. But if Ear proved in court that Sem would have lost $50,000 on the project, that would mean that Sem actually saved money by not having to perform the rest of the contract! In fact, Sem would have saved $30,000, since he lost only $20,000 of the $50,000 he would have lost if the parties had fully performed. So Sem's expectation damages would be:

	$1,000,000	(what Sem expected to get)
minus	$1,030,000	(Sem's savings by not having to complete the work, which is the $1,050,000 it would have cost Sem to do all the work, minus the $20,000 he already spent)
equals	$0	(actually -$30,000).

Sem's expectation damages are $0, because if the contract was fully performed, he would have earned no profit at all! Most courts will not award reliance damages that are bigger than expectation damages. So in this situation, Sem could probably recover no reliance damages. Of course, it might be hard for Ear to prove that Sem would have lost money on the contract, just as it might be hard for Sem to prove expectation damages. In addition, even if Sem's expectation damages are $0, he might still be able to recover restitution damages. This will be further discussed in Section 10.4 below.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.8, discusses promissory estoppel (detrimental reliance) and the situations in which it might be appropriate.

10.4 Courts May Order a Party to Pay Restitution Damages to Compensate an Injured Party for the Benefit She Provided to That Party

When a court orders a party to pay restitution damages as a result of a contract dispute, the court orders that party to pay the value of the

benefit that party has received from another party, in order to prevent unjust enrichment. This is different from expectation and reliance damages, which are measured by the harm to the injured party.

*** **DEFINITION: Restitution damages** are damages that try to compensate a party for the value of the benefit she has given to another party, in order to prevent unjust enrichment.

Courts often award restitution damages when they decide that neither expectation damages nor reliance damages are appropriate in a particular case. This may occur where the party seeking the court's help cannot enforce a contract, but the court finds a quasi-contract exists. Quasi-contract has already been discussed in Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5, and elsewhere. Restitution damages may also be appropriate where there was a valid contract, but there is some problem, and for some reason the party seeking a remedy cannot get or does not want other types of damages. These two groups of situations will be discussed in more detail in Section 10.4a, below.

Many authorities say that restitution is actually measured by the value of the benefit provided to the defendant. In theory, this means that if for some reason the benefit has no value to the defendant, there will be no damages. However, it also appears that in practice, the measure of restitution will still generally be the reasonable value (or market value) of the benefit.

10.4a Important Situations Where Restitution Damages May Be Awarded

Restitution damages may be awarded in a number of situations where the other kinds of damages discussed above are not available. In fact, there appear to be two important groups of situations where restitution damages are often awarded. These are:

(1) where there was no valid contract, but one party gave some benefit to the other party, and there would be unjust enrichment if the other party was allowed to keep the benefits she received;

and (2) where there was a valid contract, but

(a) there is a unilateral or bilateral rescission;

(b) the contract's duties are discharged by impracticability or frustration of purpose;

(c) one party breaches and the other party chooses to seek restitution because she cannot recover as much with expectation or reliance damages;

or (d) a breaching party wishes to recover what she has provided to the other party.

Most of these are quasi-contract situations. Although it is not an award of "damages," a party may also seek the return of the actual object she provided to the other party. This is called specific restitution. It appears that this remedy mainly occurs in land disputes. It will be further discussed in Section 10.7d, below.

There are a number of examples of the first group of situations, where there was no valid contract. These include situations where the parties thought they had a valid contract, but they actually did not. This might occur because of a number of the formation problems discussed in Chapters 2-7 above, such as that an agreement was too indefinite, failed to meet a writing requirement, or was the result of a mistake. In these cases, although the agreement is not valid, restitution may be awarded to avoid unjust enrichment, under the doctrine of quasi-contract.

Restitution damages may also be awarded where the parties have not even tried to make a valid contract. Consider the following Case Study.

******* ***CASE STUDY 231***

FACTS One day, a doctor named Nikea was riding his moto to the hospital where he worked. On the way, he found an accident victim named Neth lying unconscious by the side of the road. Neth, who was a wealthy restaurant owner, had many injuries and was in serious condition. Since Neth was unconscious and Nikea could not ask him whether he agreed to have Nikea treat him, Nikea simply treated Neth. Nikea provided a real benefit with a reasonable value of $50 to Neth, and Neth recovered from his injuries.

When Neth was feeling better, Nikea went to see him. Nikea told Neth that he was glad to see that he was better. He also said that helping Neth had caused him to miss work and lose some pay, so he would very much appreciate it if Neth could help him by compensating him for his services that morning. But Neth told Nikea that he had never made any promise or contract to pay Nikea, so he owed him nothing.

QUESTION OF LAW Can Nikea recover compensation from Neth for the care he provided to him by the side of the road?

DECISION Yes. Nikea will be able to recover restitution--the reasonable value of the services he provided to Neth--under the doctrine of quasi-contract.

Restitution may be awarded in situations where the parties have no valid contract, but there has been unjust enrichment of one party by another party. In this case, Nikea provided a valuable benefit to Neth by taking care of him when he was seriously injured in an accident. Of course, since Neth was unconscious, there was no real agreement between the parties, and no valid contract. However, because Nikea provided a real benefit to Neth in

a desperate situation, and Nikea actually lost some pay as a result, there would be unjust enrichment if Neth was not required to compensate Nikea. In this situation, a court would award Nikea restitution--the reasonable value of the benefit he provided to Neth, which in this case was $50--under the doctrine of quasi-contract.

Restitution is also often awarded in the second group of situations, where there was a valid contract. This can occur in a number of different circumstances.

First, it might happen where there is a rescission. This could be a unilateral rescission, when one party breaches and the other party decides to rescind and ask for restitution. It could also occur where parties decide to mutually rescind a contract. The remedy of rescission is discussed in Section 10.7b, below. It was also explained in Chapter 9 ("Performance and Discharge of Duties"), Sections 9.6b and 9.7a. For example, after a mutual rescission such as that of the parties in the Speedy Car Company contract in Case Study 218, many courts would say the appropriate remedy was restitution damages. Of course, as explained in Chapter 9, some courts allow other types of damages even where there is a rescission.

In addition, it appears that parties may be able to get restitution where duties in a valid contract are discharged by impracticability or frustration of purpose. These types of discharge were already discussed in Chapter 9 ("Performance and Discharge of Duties"), Sections 9.8a and 9.8b. Impracticability may occur because of many things, including illegality and different types of disasters. If one party gave something to another party under a valid contract which later became impracticable, or whose purpose was frustrated, it would seem that the giving party should be able to get restitution. Otherwise, there would probably be unjust enrichment.

For example, if the Special Fish Company in Case Study 224 had made payments to Nareth for fish Nareth had not yet supplied, and the contract then became impracticable, it would seem that the Fish Company could get restitution. That is because it would probably be unjust if that benefit was not returned to the Fish Company.

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties"), Sections 9.6b and 9.7a discuss situations in which unilateral and bilateral rescissions might occur, and Sections 9.8a and 9.8b discuss the effects of impracticability and frustration of purpose on contracts.

Another important situation of the second group of situations is where the non-breaching party chooses to seek restitution because she would actually recover less money--or none at all--if she asked for one of the other measures of damages. Many courts say that parties can actually recover restitution even if that would result in them getting more than if they were awarded expectation remedies. This is generally true even if the party seeking restitution

had made a "losing" contract--one where the breach actually saved her from having to perform a contract where she would have lost money!

For instance, consider the last example in Section 10.3 above. In that example, a builder named Sem wanted $20,000 in reliance damages for Ear's breach of a construction contract. But Ear showed that Sem would actually have lost $50,000 on the contract. Because reliance damages cannot exceed expectation damages, and the expectation damages were $0, Sem could not get any reliance damages. However, suppose Sem had provided $20,000 in benefits to Ear before Ear breached, perhaps by building part of the offices on Ear's land. In that case, Sem could probably recover $20,000 in restitution from Ear--even though his expectation damages were still $0! This is because restitution damages can be more than the expectation damages.

In fact, restitution can even be more than the entire contract price! Suppose Sem completed most of the office building before Ear breached. Suppose also that Sem actually provided Ear with a benefit with a reasonable value of $1,100,000, which is more than the total contract price of $1,000,000. This is actually quite possible where the builder has miscalculated how much it will cost him to build the building. Ear will argue that Sem's damages should be limited to the contract price, since that was all he expected to get. But many courts would say that Sem can actually get the full value of the benefit he has given to Ear ($1,100,000) in restitution. This is true even though that value is more than the contract price, because that is the amount of the unjust enrichment to Ear.

Finally, an important situation where parties may seek restitution occurs where the breaching party herself seeks restitution of benefits she has provided to the other party. In the past, many courts denied such a breaching party any recovery. But today it appears that most courts will often allow such a breaching party to recover restitution, under the doctrine of quasi-contract. For example, the Uniform Commercial Code in the United States allows restitution for a breaching buyer of goods. The reason for this rule seems to be that many courts feel it might be unjust if a party were allowed to keep a benefit that was not a measure of the actual harm caused to her by the breach. In fact, not allowing restitution to a breaching party could result in a penalty to that party.

There are some limits on the restitution the breaching party can get. First, the restitution such a breaching plaintiff can get will be reduced by the amount of any damage she caused to the other party. In addition, many jurisdictions do limit the amount such a breaching party can recover to the contract price. And it appears that many courts generally still deny restitution to a breaching party where that party's breach was intentional, rather than merely negligent or accidental. However, the general rule about intentional breaches may not always apply so strictly in employment contracts. Consider the following Case Study.

*** ***CASE STUDY 232***

FACTS Peo agrees to work for Chandara as an administrative officer for one year for a total salary of $12,000. The salary is to be paid in 12 $1,000 installments, one every month. Everything goes well for about six months, but at that time Peo fails to come to work. Chandara contacts Peo at her home to find out what the problem is, and why she is not coming to work. All Peo will say is that she "prefers not to" come to work.

Chandara tries to be patient, but finally she becomes angry. She refuses to pay Peo the $1,000 for the last month Peo worked, saying Peo gets nothing because she breached the contract, especially by failing to give adequate notice that she was leaving. Chandara also says the breach caused her to suffer $500 in damages, because of lost work and problems in finding a good replacement for Peo. But Peo wants her money, and she asks the court for help.

QUESTION OF LAW Can Peo recover compensation for her work?

DECISION Probably. Even if the court finds that Peo breached her employment contract, it will probably allow her to recover restitution for the benefit she has provided to Chandara (minus any damage to Chandara) under the doctrine of quasi-contract.

Courts generally allow a breaching party to recover restitution of the reasonable value of the benefits she has provided to the other party, minus the damage she has caused to the other party. Although many courts will generally not allow restitution where the breach has been intentional, that general rule often does not apply in employment contracts.

In this case, a court might find that Peo breached her employment contract with Chandara. Even so, Peo could probably get restitution for the reasonable value of the work she provided to Chandara, minus the damage she caused to Chandara by her breach, under the doctrine of quasi-contract. In this situation, suppose a court found that the reasonable value of the work Peo provided in the six months she worked was actually $6,000, or the amount she would have been owed under the contract itself. Chandara has only paid $5,000 of this amount, and $1,000 remains. However, suppose Chandara proves that she has suffered $500 in damages because of the breach. The court would subtract that $500 from the $1,000 Chandara did not pay, and award Peo $500 in restitution damages.

Many jurisdictions also have statutes that generally require employers to pay employees like Peo in Case Study 232 at certain intervals, and require that employers pay such employees for work they have actually done--even if those employees have breached their employment contracts. Of course, employers are still entitled to damages for any harm caused to them by such breaches.

The following illustration provides some examples of how restitution damages are calculated.

Illustration: How to Calculate Restitution Damages

STEPS	EXAMPLES		
	Example 1 (Case Study 231 -- Nikea)	**Example 2 (Sem and Ear (construction))**	**Example 3 (Case Study 232 -- Peo)**
Step 1: What happened?	Nikea provides needed health care with a reasonable value of $50 to the unconscious Neth lying by the side of the road	Sem provides $1,100,000 in benefits to Ear, Ear breaches, Ear claims Sem's damages limited to contract price of $1,000,000	Peo breaches employment contract, Chandara has not paid Peo for $1,000 worth of work, breach causes $500 in damage to Chandara
Step 2: How much unjust enrichment has a party received? This amount is the RESTITUTION DAMAGES	$50	$1,100,000	$500 ($1,000-$500)

Restitution is more flexible in some ways than the other kinds of damages discussed above, since it is available in situations where those other kinds of damages are not. But restitution is still subject to the important limits which are discussed above and will be further discussed in Section 10.6, below. Specifically, restitution damages must be reasonably certain and reasonably foreseeable, and the party seeking to recover must not have been able to reasonably avoid them.

10.4b Restitution Compared to Other Kinds of Damages

As noted above, restitution is different in important ways from other kinds of money damages. This Section will briefly compare restitution to expectation and reliance damages, which were discussed in Sections 10.2 and 10.3, above.



Illustration: Expectation vs. Reliance vs. Restitution Damages

	EXPECTATION	RELIANCE	RESTITUTION
Step 1: What is the goal?	Put injured party in position she would have occupied if parties had fully performed contract	Put injured party in position she occupied before contract	Prevent unjust enrichment of party who has received some benefit from another party
Step 2: How is it determined?	Additional benefits injured party expected minus any amount she saved by not having to fully perform	Amount needed to compensate injured party for her efforts or expenses in reasonable reliance on the contract or promise	Value of the benefit given to a party that constitutes unjust enrichment (usually the market value or reasonable value)
Step 3: When is it likely to be used?	General money damages remedy used where party breaches contract; used if appropriate	Where expectation damages not appropriate for some reason, especially where expectation too uncertain; in promissory estoppel situations	Where no valid contract but court finds quasi-contract; where valid contract but rescission, impracticability or frustration of purpose; non-breaching party cannot recover as much in other ways; or breaching party seeks remedy for benefit she gave

In some cases, parties may wonder whether they should ask a court for restitution or reliance damages. In general, restitution will be no more than reliance. This is because whatever a party gives to another party will generally be part of her reasonable reliance. In fact, in many cases, restitution damages will be the same as reliance damages. For example, suppose Ann and Reth agree that Ann will pay Reth $1,000 for Reth's moto. Suppose Ann pays Reth $300 as a down payment, and then Reth breaches the contract by failing to deliver the moto. Ann may decide to rescind and ask a court to order restitution damages, perhaps because expectation damages will be difficult to prove. In this case, restitution damages would be $300. That is the reasonable value of what Ann has given to Reth, and that would be the amount of the unjust enrichment to Reth. But it would also be the reliance damages. This is because $300 would also be the amount of money Ann has spent in reasonable reliance on the contract. So in this case, and many others, restitution and reliance would be the same amount.

However, in other cases, restitution will be less than reliance. For example, in the restaurant example in Section 10.3 above, where Yutho spent $2,000 getting ready for a new restaurant to open before Chan breached, Yutho's reliance damages were $2,000. But her restitution damages might be $0, if she had not actually given any benefit to Chan.

In that situation, Yutho would be wise to ask a court for reliance damages, not restitution damages.

Another situation where restitution and reliance might not be the same would occur in the accident victim example in Case Study 231, involving Neth and Nikea. Suppose Nikea was actually a famous surgeon, with a highly specialized practice, who charged very high rates. In that situation, courts awarding restitution would probably say that the reasonable value of what Nikea had given to Neth--the amount of unjust enrichment--was the fee usually charged in the community where the accident occurred for services like those he provided to Neth. In other words, Neth would have been "unjustly enriched" to this extent, but not more. The reasonable value would probably not be the surgeon's usual fee, which would be far more expensive, unless Nikea had actually performed the kind of specialized surgery he normally did. That usual higher fee would be more like reliance damages. This is because that fee is what would be required to compensate Nikea for the efforts he made in reasonable reliance. In any event, restitution--not reliance--damages would probably be ordered in this situation.

Finally, in some situations, the amount of restitution damages parties can recover might actually be more than the reliance damages they can recover. This could happen in the situation where a party is seeking to recover damages for breach of a losing contract--a contract on which that party would actually have lost money. This was discussed in Section 10.4a above. Many jurisdictions say that parties cannot recover reliance damages greater than their expectation damages. So a party who would have lost money on a contract may not be able to recover any reliance damages. But that party may be able to recover restitution damages, if she has given some benefit to the breaching party, and unjust enrichment might otherwise occur. This was the case in the construction example with Ear and Sem discussed in Section 10.4a.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5, and many other Chapters in this text, discuss quasi-contract and the situations in which it might apply.

10.5 Courts May Order a Party to Pay Other Damages or Monetary Awards in Certain Situations

In many jurisdictions, the three types of remedies discussed in Section 10.4 are the main types of damages remedies courts order when they decide that some action is appropriate in a contract dispute. However, in some



situations, courts may consider other types of damages remedies or monetary awards. This Section will discuss four of these:

(1) stipulated (liquidated) damages (Section 10.5a);

(2) nominal damages (Section 10.5b);

(3) interest (Section 10.5c);

and (4) punitive damages (Section 10.5d).

10.5a Courts May Order a Party to Pay Stipulated (Liquidated) Damages Where the Contract Itself Describes the Damages to Be Paid for a Breach

Sometimes the parties actually agree in their contract what the amount of damages will be for a breach of the contract, or how those damages will be calculated. These are called "stipulated" (or "liquidated") damages, because the amount is actually stipulated in the contract.

*** **DEFINITION:** A **stipulated or liquidated damages clause** is a contract provision that specifies the amount of damages one party must pay another party in the event that the first party breaches the contract.

Often stipulated damages provisions are enforceable, but sometimes they are not. If such a provision is enforceable, then the party who is seeking damages may recover only the damages the clause says she can recover. But if such a provision is not enforceable, courts in many jurisdictions will award only damages that a party can prove actually occurred.

The requirements for stipulated damages clauses to be enforceable appear to vary in different jurisdictions. It appears that civil law jurisdictions are more likely to enforce stipulated damages clauses, even if they may appear to be a kind of "penalty" for the breaching party. Obviously, a severe stipulated damages clause might strongly motivate a party to perform her contract duties as required by the contract. However, it appears that the recent trend in civil law jurisdictions such as France is to allow a court some discretion to reduce or increase the amount specified in the clause if it is clearly excessive or too small with regard to the circumstances of the case.

Courts in many common law jurisdictions will generally not enforce a stipulated damages clause if they feel that the clause is really a punishment of one of the parties. This is because of the general view of such courts that punitive damages are not appropriate in contract situations. These courts will not enforce such punitive clauses because they believe that the goal of awarding contract damages should be to compensate the injured party for the actual harm she has suffered--not to punish. This view will be discussed further in Section 10.5d below.

Common law jurisdictions do not appear to agree on exactly how to decide whether a stipulated damages clause is enforceable. Many common law jurisdictions now say that clauses providing for stipulated damages are enforceable only if the amount of damages specified in the stipulated damages clause is:

(1) reasonable compared to the damages the parties might have expected when they made the contract;

OR (2) reasonable compared to the damages that actually resulted from the breach.

It appears that such jurisdictions say that if the party seeking to enforce the stipulated damages clause can meet either one of these requirements, the clause will generally be enforced.

Some common law courts also appear to consider a number of other factors, in addition to the "reasonable" requirement noted above. Many courts say that, in analyzing whether a stipulated damages clause should be enforced, they also consider whether the damages that actually result from a breach are difficult to estimate or to prove. If such damages are difficult to estimate or to prove, these courts are more likely to enforce the stipulated damages clause. It appears that this difficulty could be measured at the time the contract was made, or at the time of a lawsuit about the breach. An example of such a difficult situation might be where the contract relates to a new business. In any case, although courts consider this factor, it seems less important than the "reasonableness" requirement above. In addition, it appears that some courts will not enforce these clauses if no actual damage or only trivial damage occurred because of the breach. Other courts may have variations of the above rules. Obviously, it is important to check the local law to see which (if any) of these additional factors apply.

For example, suppose Thunna agrees to buy a large quantity of cement from Chheng for $200,000. The contract requires that all the cement be delivered on a certain date, and says that if the delivery is late, Chheng must pay Thunna $50,000 in stipulated damages. Chheng is one day late delivering the cement, and as a result Thunna loses about $1,000 in labor and equipment costs, because he is delayed in starting a construction job. In this case, the contract's stipulated damages clause is probably not enforceable. This is because it is probably punitive. It does not seem reasonable compared to what the parties might have expected at the time they made the contract, and it was certainly not reasonable compared to the actual damages of $1,000. It would also not seem that Thunna's damages would be difficult to prove. So Thunna would probably be limited to the damages he could prove.

*** ***CASE STUDY 233***

FACTS Sitha agrees to build a big new house for Hong for $100,000. Hong plans to rent the house after it is built, and expects to receive around

$3,000 per month for it when it is finished. The written contract says that Sitha must complete the house by March 1. The contract also contains a clause saying that if Sitha fails to complete the house by March 1, Sitha must pay Hong $5,000 per day for every day after March 1 that the house is not finished.

Sitha and his crew work hard, but they are unable to complete the house by March 1. They finish four days late. As a result, Hong is unable to get rent for the house for those four days, which causes Hong to lose about $400. Sitha admits that he is late, and offers to pay Hong some money because of the delay. But Hong points to the contract and demands $20,000.

QUESTION OF LAW Can Hong enforce the clause which requires Sitha to pay him $5,000 for every day the house is late?

DECISION Probably not, at least in common law jurisdictions. The clause requiring Sitha to pay Hong $5,000 for every day the house was late does not appear to be reasonable compared to the damages Hong might have expected or his actual damages, so it is unlikely to be enforced.

Stipulated damages clauses are generally enforceable in common law jurisdictions if they are reasonable in comparison to the damages a party could have expected when she made the contract, or reasonable compared to her actual damages because of the breach. Many courts are more likely to enforce such clauses if the damages are hard to estimate or prove.

In this case, the contract Sitha and Hong signed said that Sitha had to pay Hong $5,000 for every day Sitha was late in completing the construction of a new house for Hong. Sitha was four days late, and as a result Hong lost about $400 in rent for the house. In this situation, the stipulated damages clause does not appear reasonable based on the expected or actual damages, which were only around $300. There is no evidence that Hong had any reason to expect $5,000 per day in damages at the time of the contract. In fact, it would seem that around $100 per day would have been reasonable, since that is about the amount Hong expected to get in rent--and that was the amount he actually lost. There is no evidence that damages were difficult to calculate or prove. So a common law court would probably consider this stipulated damages clause to be a "penalty," and not enforce it. Hong would be limited to the damages he could actually prove under the usual rules--probably about $300.

Some authorities might argue that courts should enforce clauses like the one in Case Study 233. One reason to enforce such clauses might be that it would provide a strong motivation for parties to perform their contract duties in a diligent way. It could also be argued that parties like Sitha assume the risk of having to pay such penalties when they sign such contracts, so they should have to pay, even if the amount seems too high.

In general, where there is a severe stipulated damages clause in a contract, a party can also ask a common law court not to enforce the clause on the basis that it is unconscionable. For example, where an extremely unfair stipulated damages clause appears in an adhesion contract, a court may refuse to enforce it on this basis. Such a clause might provide for unreasonably high damages for the more powerful party, or unreasonably low damages for the weaker party. However, as discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.7, unconscionability is applied only in limited cases.

Contracts might also say that certain kinds of remedies will or will not be available to a party in the event of a breach by the other party. For example, a sale of goods contract may contain a clause limiting the damages a party can get if the goods are defective. A lease contract might limit the damages a lessee can get in the event that the leased property is defective or causes harm. As discussed in Chapter 5 ("Legality") and Chapter 7, these kinds of clauses may be unenforceable where they violate statutes or public policy, or where they are found to be unconscionable. These remedies will be further discussed in Section 10.7d, below.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.4g, and Chapter 7 ("Other Contract Formation Problems"), Section 7.7, discuss when contract provisions may be unenforceable because they violate public policy, or because they are unconscionable.

10.5b Courts May Order a Party to Pay Nominal Damages Where a Breach Has Occurred but No Real Harm Is Proved

Sometimes a party proves that a contract breach occurred, but cannot or does not prove that any actual damage occurred. In that situation, a court may choose to order nominal damages for the party seeking a remedy.

*** **DEFINITION: Nominal damages** are a small sum set by the court and awarded to a party seeking damages principally to show that another party has committed a legal wrong against the first party, even though the party seeking damages has proved no real harm.

Nominal damages may not seem to be worth the trouble it would take to get them! However, there may actually be some important advantages to an award of nominal damages. One advantage in many jurisdictions is that such an award may allow parties to recover their court costs from the other party. This is because civil procedure rules in many jurisdictions say that losing parties must pay the court costs of winning parties. Court costs are basically things like filing fees and witness fees required by standard court rules. In general, few of these individual fees are likely to be very high by themselves, but altogether they could add up to a substantial sum. In addition, as noted in Section 10.1 above, some jurisdictions (such as England) say that the losing party must generally pay the attorneys' fees of the winning party.

Attorneys' fees can be very large. So proving a contract breach occurred could be very important in that situation, even if no actual damages can be proved.

*** ***CASE STUDY 234***

FACTS Vichett makes a contract with Kesaro. In the contract, Vichett agrees to paint a portrait of Kesaro's beloved daughter in time for Kesaro to give the portrait to his wife for the New Year celebrations. However, Vichett never even starts to paint the painting, and he simply laughs when Kesaro comes to ask for it at the New Year.

Kesaro is angry. He has not yet paid any money. He knows he probably cannot show any great amount of damages, and that it is too late to have anyone paint the portrait now. But he finds an inexpensive attorney and asks the court for help anyway. It takes a few months for the case to be decided, during which Kesaro must pay certain court costs.

QUESTION OF LAW Can Kesaro recover any damages for Vichett's breach?

DECISION Yes. Kesaro can recover nominal damages, even if he is unable to show any real damage.

Where a party does not or cannot show any real damage because of a contract breach, that party may still be able to get a small sum as nominal damages. These show that the other party did breach the contract. In many jurisdictions, this showing also gives the non-breaching party the right to recover her court costs from the breaching party. In some jurisdictions, the breaching party may also have to pay the other party's attorneys' fees.

In this case, Vichett breached the contract to paint a portrait of Kesaro's daughter. Even though Kesaro cannot show any real damages, the court may award him nominal damages. In many jurisdictions, this will mean that Vichett will have to reimburse Kesaro for his court costs. In some jurisdictions, Vichett will also have to pay Kesaro's attorneys' fees. Vichett is unhappy. Kesaro uses the nominal damages to take his wife and daughter out to a restaurant.

10.5c Courts May Order a Party to Pay Interest in Contract Disputes

Where a court awards money damages to a party, that party may also be able to recover interest on her damages. This can occur in several ways.

First, most jurisdictions say that parties may recover interest on the amount of the court judgment from the time of the judgment until the judgment is paid. The rate of interest is generally set by a statute.

Second, many jurisdictions say that a party may also be able to recover interest on the amount of the damages for a contract breach from the time of the actual breach to the time of the court judgment. This is called "pre-judgment interest." Many courts have traditionally ordered pre-judgment interest only if the amount of damages was certain at the time of the breach. Generally this occurs where a party simply fails to pay some amount of money as required by the contract. If a party fails to pay a specific amount of money as required by a contract on a certain date, it is easy to calculate the amount of interest from that date until the date of the judgment. The rate of such interest is usually set by a statute.

In addition, some jurisdictions now appear also to allow the non-breaching party to recover interest from the time of the breach even where the amount of damage is not so clear. An example would be where Sikoeun breached by providing defective services to Sary under a service contract. Sikoeun might not know how much he owes Sary until a court actually determines the damages. But some jurisdictions now allow their courts some discretion to award pre-judgment interest even in these situations. In the above example, a court might be able to determine some amount that would basically be the value of the services that Sikoeun failed to provide. Then the court might order that Sikoeun pay interest on that amount from the time of the breach. Of course, determining this amount might not be easy. And it is debatable whether it is fair to expect a breaching party like Sikoeun to have made this calculation at the time of the breach.

Finally, the contract itself may provide for interest if there is a breach. Courts enforce such clauses as long as they do not violate usury laws, as discussed in Chapter 5 ("Legality").

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.3c discusses when contract provisions may be unenforceable because they violate usury statutes.

Interest can make a big difference in the amount a breaching party finally pays for her breach. Consider the following Case Study.

*** ***CASE STUDY 235***

FACTS The Peerless Power Company signed a contract with the Ministry of Power to build several big new power plants for a total price of $50,000,000. The contract called for a $20,000,000 payment at the time of the signing, and for the remaining $30,000,000 to be paid when the plants were completed two years later.

The Ministry made the first payment, and Peerless completed the plants according to the contract. Unfortunately, the Ministry did not make the final $30,000,000 payment when it was due. Peerless and the Ministry tried to negotiate about the problem, but the negotiations failed.

Several months after the breach, Peerless brought a lawsuit. One year after the breach, Peerless obtained a court judgment for $30,000,000, plus interest from the time of the breach at the statutory rate, which was 10% simple interest per year.

Peerless had difficulty collecting the judgment. Finally, one year after the judgment, the Ministry tried to pay Peerless $30,000,000. Peerless told the Ministry it wanted the interest also. The Ministry said "what interest?"

QUESTION OF LAW Can Peerless recover interest on its damages in this situation?

DECISION Yes. Peerless can recover 10% per year simple interest on the $30,000,000 judgment from the time of the breach two years earlier until the judgment is paid, for a total of about $36,000,000.

When a contract is breached, the non-breaching party can recover interest on the damages from the time of judgment until the judgment is paid. In many jurisdictions, that party can also recover interest from the time of the breach itself until the time of the judgment, at least where the amount of damages was certain from the time of the breach.

In this case, the Ministry breached its contract with Peerless by failing to pay the $30,000,000 it owed for the construction of the power plants. Peerless got a court judgment for this amount and interest from the time of the breach. But Peerless was unable to collect the judgment until two years after the breach. In this situation, the Ministry does not owe Peerless merely the amount of the judgment. It also owes interest on those damages from the time of the breach until the judgment is paid. That will be $30,000,000 plus 10% simple interest per year for two years, or about $36,000,000. So the interest on the judgment in this case was worth $6,000,000.

10.5d Courts Resolving Contract Disputes Generally Do Not Order Parties to Pay Punitive Damages

As explained in Section 10.1, courts in free market jurisdictions generally do not order a party to pay punitive damages solely for a breach of contract, or for making an unenforceable contract. The reason is that the basic idea of contract remedies in these jurisdictions is to compensate the injured party for the actual harm done to her--not to punish the other party.

*** **DEFINITION: Punitive damages** are damages a court awards in order to punish a party who has committed some civil wrong, and to deter her and others from committing such wrongs in the future.

Punitive damages are usually used to punish people who have committed some serious moral wrong, such as a tort. So such damages may be based on the wealth of the defendant and the moral seriousness of the wrong.

But contract breaches are not generally considered to be such serious wrongs. Of course, if a party actually commits a tort such as fraud, then punitive damages may be available. But the general rule is that punitive damages are not available in contract disputes.

There may be some differences in the approach of different jurisdictions to this subject. In particular, civil law jurisdictions may be somewhat more willing to allow damages that are more "punitive" in certain particular situations. This was explained in the discussion of stipulated damages clauses in Section 10.5a, above. However, it appears that the main goal of damages in civil law jurisdictions (as in common law jurisdictions) is to compensate the non-breaching party for the actual harm to her, not to punish the breaching party. So the approaches of these systems seem to be generally comparable.

As noted above, one situation in which punitive damages might be available is where a party commits a wrong related to a contract that is also a tort. This might occur because a party uses a contract to commit a tort. Or it might occur where a party's breach of a contract actually is a tort, in addition to a breach. The exact situations where this may occur will depend on the law in each particular jurisdiction, so it is important to check the local law.

One important example might be where a party's breach of a contract is also fraud. For instance, suppose Hy intentionally misrepresents to Chanty that Hy's car has traveled only 500 kilometers since it was made. However, Hy has altered the odometer to hide the fact that the car actually has traveled 10,000 kilometers! If Chanty buys the car from Hy on the basis of Hy's statement about the distance the car has traveled, it would probably be fraudulent misrepresentation. That would create a voidable contract, as discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.4. But since fraud is also a tort, Chanty might also be able to recover punitive damages in order to punish Hy and deter such conduct in the future. Of course, in these cases, the award of punitive damages occurs because of the tort, not because there is a contract problem.

Another situation involving contracts in which punitive damages might be available is where there is a "bad faith" breach of a contract. This was discussed in Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c. Many jurisdictions say that, in certain special situations, to breach a contract in bad faith--in violation of the duty of good faith and fair dealing--is actually a tort. However, courts have had trouble defining exactly when the tort exists. Most courts have been careful to limit this tort to certain types of cases. Basically, these cases seem to occur where:

(1) there is some special relationship between the parties to the contract which involves elements such as the public interest and adhesion;

or (2) a party's conduct in breaching is notably malicious, oppressive, unreasonable, or unjustifiable.

Obviously, it is difficult to say exactly when these requirements might be met. Probably the most important area in which courts have found this to occur is in insurance contracts. Specifically, it may occur where an insurance company refuses in bad faith to pay a claim submitted by one of its policyholders, even though the company has no legitimate reason to refuse. Of course, such conduct would be a breach of the insurance contract. But some courts have also found it to be a tort. Another situation where some courts have found the tort of bad faith to exist is where a party denies without any legitimate reason that a contract even exists. In situations like these, punitive damages may be available to punish the breaching party, and deter others from doing the same thing. Consider also the following Case Study.

*** ***CASE STUDY 236***

FACTS Suppose that the facts in Case Study 211 happened in a somewhat different way. Suppose that Better Homes Construction and the Queen Group real estate development company had the same contract for Better Homes to build 10 houses, except that the contract contained no arbitration clause.

However, in this new case, before Better Homes even starts to perform the contract, Better Homes decides that it is not a good deal for it to continue with the contract. This is because Better Homes has made a mistake in setting the price for the job. The result of that mistake is that the contract is not profitable for Better Homes. In order to escape the contract, Better Homes falsely claims that the Queen Group has failed to supply it with the construction plans it needs to build the houses. Better Homes says it is terminating the contract before work has even begun.

The Queen Group asks the court for help. It claims $30,000 of damages to compensate it for Better Homes' breach, and an additional $20,000 in punitive damages for what it says was the tort of bad faith breach by Better Homes.

QUESTION OF LAW Can the Queen Group recover punitive damages on the basis that Better Homes has acted in bad faith?

DECISION Perhaps. The Queen Group may be able to recover both compensatory damages and punitive damages, if it can show that Better Homes' breach of the contract was actually in bad faith and a tort.

Although punitive damages are generally not available for breach of contract, they may be available, at least in certain cases, where a party can show that a breach was also an act of bad faith and a tort. In this case, Better Homes wanted to escape from the contract because it was a bad deal. In order to do that, Better Homes falsely claimed that the Queen Group had failed to supply it with the required construction plans, and terminated the contract without justification. Some courts might find this conduct to be

a bad faith breach of the contract and a tort--and award the Queen Group the $20,000 it seeks in punitive damages, in addition to the $30,000 it seeks in compensatory damages.

A court might do this if it believed that the conduct of Better Homes was so unjustifiable and malicious that it was a serious moral wrong for which such damages should be available. Obviously, this is not an easy question. What do you think?

*** ***WHY IS THIS IMPORTANT?*** Why do some jurisdictions say that a "bad faith" breach of a contract can actually be a tort which would justify punitive damages?

As discussed above, torts are serious moral wrongs. Societies generally say that courts may award punitive damages for such wrongs, in order to punish those who commit them and deter those who might commit them in the future. There may be situations where a breach of contract is in fact such a serious moral wrong that it would justify punitive damages. Case Study 236 may be an example of such a situation. This is because a court might find that Better Homes' breach in that case was so malicious and unjustifiable--perhaps because it involved knowingly making a false claim to escape the contract--that Better Homes should be subject to punitive damages.

On the other hand, as noted in Section 10.1 above, some authorities have argued that it might sometimes be more economically efficient for parties to breach unproductive contracts, and pursue activities that are more productive, as long as the non-breaching party is adequately compensated for the breach. For example, in Case Study 211, Better Homes breached the contract in order to pursue a much larger project to build 50 houses for the Big White Villa Company. Although the Queen Group would obviously be compensated for damages caused by Better Homes' breach, it is debatable whether punitive damages should be used in a situation like that to deter conduct such as that of Better Homes. The reason is that it is arguably more productive if economic actors like Better Homes do the work in which they can be most productive, which in this case would probably be the larger contract. Some authorities have called this an "efficient breach." This argument might even be made for the situation in Case Study 236, in the sense that it might be more efficient for Better Homes not to perform a losing contract, but to try to find other work. It may be that the "bad faith" that case was not so much that Better Homes breached, but that it knowingly made a false claim in order to escape its obligations.

Of course, the "efficient breach" theory may not seem fair to parties like the Queen Group. It might also lead to less faith in contracts--which could hurt the economy. As noted above, courts can never fully compensate parties for contract breaches in any case. In addition, the fact that parties and courts must devote time and resources to resolving legal disputes is itself a burden on the economy. So it is not an easy issue to resolve.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.4 discusses contracts which are the result of misrepresentation; and Chapter 8 ("Interpretation of Contracts"), Section 8.3j, and Chapter 9 ("Performance and Discharge of Duties"), Section 9.5c discuss the duty of good faith and fair dealing.

10.6 There Are Several Important General Limits on Damages Parties Can Recover in Contract Disputes

When courts award damages to a party harmed by a contract breach or other contract problem, the goal is generally to compensate the party for the losses she has suffered. However, the ability of courts to award such damages is limited by a number of rules. In general, these rules are designed to try to ensure that the amount of damages awarded is fair to both the party harmed and the party who has caused the harm. The rules also try to promote economic and judicial efficiency. Some limits apply especially to certain types of damages, or only to certain types of damages. Many of those limits were discussed in Sections 10.2-5 above.

As noted earlier, three of the most important general limits on the damages that a party can recover in a contract dispute are that such damages must:

(1) be proved with reasonable certainty;

(2) be foreseeable by a reasonable person;

and (3) not be damages that the party seeking them could reasonably have avoided.

Each of these general limits is discussed below.

10.6a Parties Can Generally Recover Only Damages That They Prove with Reasonable Certainty

One important general requirement for a party to recover damages in a contract dispute is that the party must prove the damages with reasonable certainty. This means that a party who wishes to recover damages must not only show that she has suffered some harm, but also show the amount of such harm with reasonable certainty. If she cannot show this, then she cannot recover those damages. This rule is especially important when courts are considering whether to order that a party pay expectation damages, especially for lost profits. However, it is important to remember that courts do not require that the amount of such damages be completely certain--only that it be reasonably certain.

For instance, in the restaurant example in Section 10.3 above, Chan and Yutho made a contract to form a partnership and start a new restaurant. But Chan breached the contract before the new restaurant could open.

In that situation, Yutho would have difficulty proving her expectation damages with reasonable certainty. That is because, as discussed in Section 10.3, Yutho's expectation damages would involve proving what profits the restaurant would have made if it had opened. This can be very difficult to do with new businesses, especially restaurants. Therefore, Yutho might be unable to get expectation damages. Of course, she could still ask a court to award her reliance damages.

The reasonable certainty rule makes it difficult for parties to recover for lost profits when a new business is involved. However, as noted in Section 10.3, parties may be able to recover such damages if the business is not so new, or if the person starting the new business can offer good evidence of the profits from her operation of a similar business in the past, or even of the profits of other comparable businesses. That kind of evidence could be used to make a reasonable estimate of future profits of the business affected by the breach.

For instance, in the restaurant example above, suppose Chan breached the contract after the restaurant had been open for some time. If the breach caused a clear negative effect on the restaurant--such as if it had to close down, or the volume of its business went down sharply--Yutho might be able to show expectation damages with reasonable certainty. This is because she could use the history of the profits the business had already made to show what the restaurant could reasonably have expected to earn in the future. Or suppose Yutho had years of experience successfully running chicken restaurants like the one she planned to open with Chan. In that situation, Yutho might be able to use evidence of the profits in those prior businesses to help her show what the new restaurant would have earned. Of course, it might still be fairly difficult to do this, because of the many uncertainties of the restaurant business.

The reasonable certainty rule is also important in other types of situations. One is construction contracts, such as in the case of Ear and Sem which was discussed in Section 10.3 above. In one of the examples relating to that case, Sem had trouble showing how much it would have cost him to finish a construction job. So he was unable to prove his expectation damages with reasonable certainty, and he could not recover those damages. However, he could probably have proved his reliance or restitution damages more easily.

Another type of situation in which the reasonable certainty rule can be important is where parties ask for profits they have lost because of breaches of contracts that involve the "public whim," such as entertainment or sports events. Consider the following Case Study.

******* ***CASE STUDY 237***

FACTS The Royal Dance Company and a dancer named Vannrath sign a contract under which Vannrath is to dance the crucial part of the apsara

in the biggest dance performance of the year. The performance is scheduled to occur at the Royal Theater two months after the contract is signed.

However, only two weeks before the performance, Vannrath gets a big part in a film that some well-known filmmakers are about to make about Cambodian dance. Vannrath cannot do both things. So she makes an anticipatory repudiation of her contract with the Royal Dance Company. The Dance Company is stunned, and they are unable to find anyone else to perform the part on such short notice.

The Dance Company asks Vannrath to compensate them for her refusal to perform. But they cannot reach her because she is too busy traveling the world to make the film. Finally, they ring her lawyer in Sydney and ask for the profits they would have made if Vannrath had performed (their expectation damages). Vannrath's lawyer says "sorry, mate," but those profits cannot be shown with reasonable certainty, so they cannot be recovered. The Dance Company says it has evidence that comparable performances by Vannrath in recent years have earned the dance companies with which she danced $30,000-50,000, and that the Company's own recent performances have earned it $25,000-40,000.

QUESTION OF LAW Can the Royal Dance Company recover the profits the Company lost because of Vannrath's breach?

DECISION Perhaps. The Company could have trouble showing the amount of such lost profits with reasonable certainty, but it might be able to do so with evidence of profits made in comparable performances in the past.

When parties try to recover profits lost because there has been a breach of a contract involving the public whim, they may have difficulty proving those damages with reasonable certainty. However, they may be able to do so if they can find good evidence of profits made from comparable performances in the past.

In this case, Vannrath breached her contract to dance for the Royal Dance Company, and the Company almost certainly lost some profits as a result. However, the Company may have difficulty showing its losses with reasonable certainty. It could try to use evidence of profits earned by comparable performances in the past, such as the evidence it has that performances by Vannrath in recent years have earned the dance companies with which she danced $30,000-50,000, and the evidence that its own recent performances have earned it $25,000-40,000. A court might accept these figures as reasonable estimates of what the Company would have earned from Vannrath's dancing, taking into account all the circumstances of the case. Or the court might decide that it simply cannot say whether the performance would have earned the Company $25,000, or $50,000, or some other figure, and refuse to award those damages. In that case, the Company might at least try to recover reliance or restitution damages.

10.6b Parties Can Generally Recover Only Damages That a Reasonable Person Could Have Foreseen

Another important limit on damages is that a party can generally recover only damages that a reasonable person could have foreseen at the time the contract was made. If a reasonable person could not have foreseen some damages that occurred because of a breach, then the party harmed cannot recover those damages--no matter how severe they are!

In applying this "reasonably foreseeable" rule, many jurisdictions say that parties may recover two types of contract damages:

(1) damages that are a natural and usual result of a breach of the type of contract involved in a dispute ("general damages");

AND (2) damages that occur because of special circumstances in the particular case only if the non-breaching party shows that the breaching party actually knew about the special circumstances ("consequential damages").

Courts generally assume that damages in the first category--those that are the usual and probable result of a particular breach--are reasonably foreseeable. But damages of the second type--which depend on the special circumstances of a particular case--are considered to be reasonably foreseeable only if the breaching party actually knew about those circumstances. Therefore, those "consequential" damages can be recovered only if the non-breaching party shows that the breaching party knew about the special situation that caused them.

For example, suppose Ponnarith has a contract to make certain forms (documents) for the government and supply them by a certain date. The contract has a stipulated damages clause that says Ponnarith must pay a certain amount to the government for every day the forms are late. In order to make the forms, Ponnarith makes a different contract to buy paper from Tahvay for $5,000. Unfortunately, Tahvay fails to deliver the paper on time. Ponnarith is able to find another supplier to get the paper, but despite his reasonable efforts to get a good price he must pay $7,000 for the substitute paper. In addition, he is unable to get the paper in time to meet the deadline in his contract with the government. As a result, he also owes the government an additional $1,000 because of the stipulated damages clause in the government contract.

In this case, Ponnarith has suffered damages of both of the types described above. His damages in having to pay more for the replacement paper (the extra $2,000) are of the first type described above. That is because they are a natural and usual result of a breach of this type of contract. It is generally known that prices of goods go up and down, and that a breach of any sales contract may result in this kind of harm. Because these damages

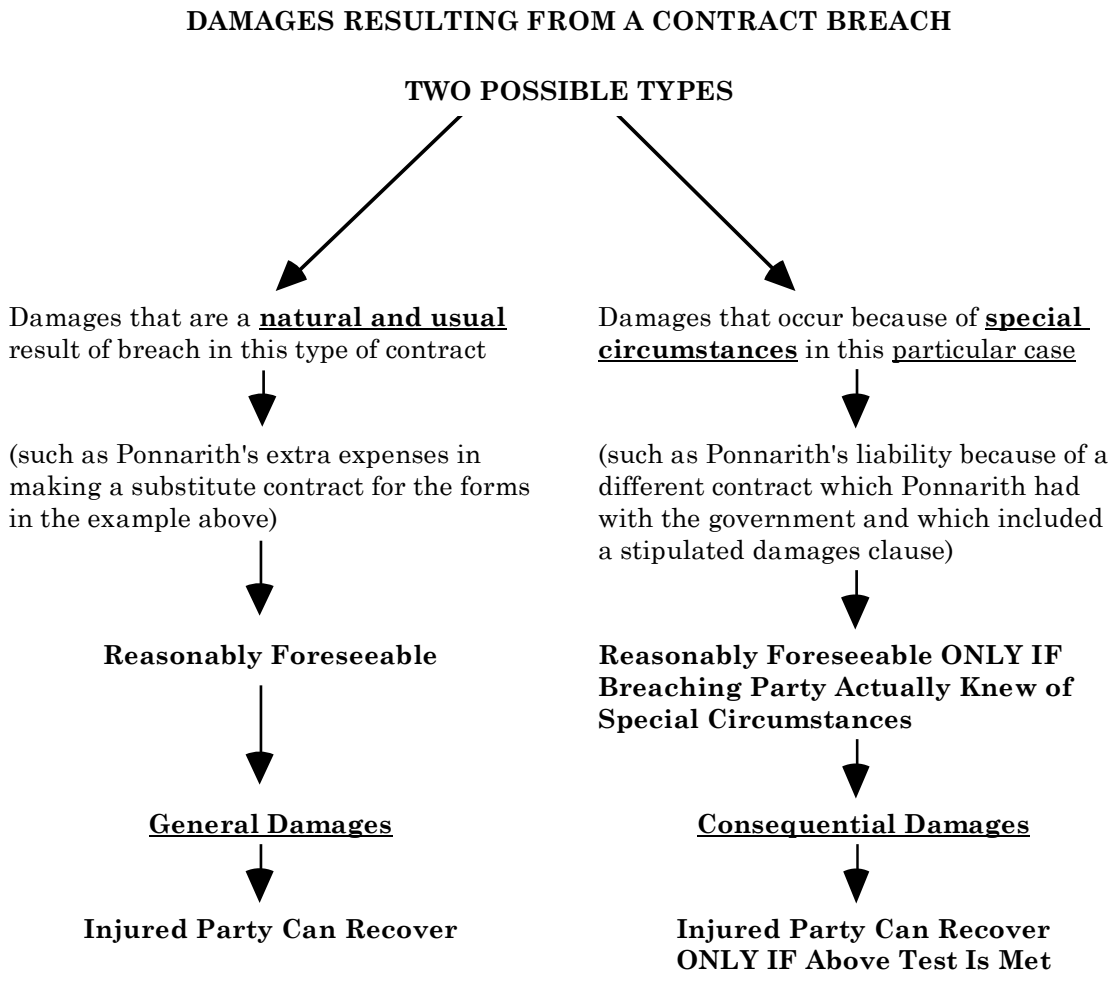
are reasonably foreseeable, Ponnarith will probably be able to recover them from Tahvay.

But Ponnarith has also suffered damages of the second type above. The damages Ponnarith had to pay to the government for the delay (the $1,000) are not a natural and usual result of this kind of breach. Instead, they are the result of the special circumstances in this case, which are that Ponnarith had a different contract with a strict due date and a stipulated damages clause. This kind of damage is reasonably foreseeable only if Ponnarith can show that Tahvay actually knew of the particular situation that caused the damage. In this case, that would probably mean Tahvay would have to have known about the government contract and the stipulated damages clause, and to have known that Tahvay's breach would be likely to prevent Ponnarith from performing the government contract on time. Ponnarith might have difficulty showing that Tahvay knew these things, unless Ponnarith had actually told Tahvay about them. So Ponnarith might not be able to recover the additional $1,000 from Tahvay.

The chart below illustrates when parties can recover the two types of damages discussed above.



Illustration: Recovery of Reasonably Foreseeable Damages



The following Case Study also illustrates the difference between general and consequential damages.

*** ***CASE STUDY 238***

FACTS The Big Bear Beer Corporation operated a huge brewery. One day, a very important piece of machinery at the brewery broke, forcing the entire brewery to shut down until the machinery could be repaired. The president of Big Bear Beer had the machinery taken to Yoeung, a carrier. Yoeung promised to deliver the machinery within two days to the Machine Repair Company, which was very far away, so the part could be fixed. Big Bear Beer did not tell Yoeung what the broken part was, or that the brewery had been shut down.

Unfortunately, Yoeung did not deliver the part to the Repair Company until a week later. As a result, the part was not returned to Big Bear Beer until five days later than it would have been if Yoeung had delivered it

on time. The Big Bear Beer Corporation lost five extra days of profits. Yoeung did not learn that until after the part was delivered to Big Bear Beer. But the President of Big Bear Beer was very upset with Yoeung. She threatened to bring a lawsuit to recover the five days in lost profits from him.

QUESTION OF LAW Can Big Bear Beer recover damages for the five days of profits it lost because Yoeung failed to deliver the broken part to the Repair Company on time?

DECISION Probably not. Big Bear Beer probably cannot recover damages for the lost profits because such consequential damages were due to special circumstances, and Yoeung did not know of those circumstances until after the damage occurred.

When damages caused by a contract breach are not a natural and usual result of the kind of breach involved--when they are consequential damages--a party can recover those damages only if she can show that the breaching party actually knew about the special circumstances that caused them at the time the contract was made.

In this case, Yoeung breached his contract with Big Bear Beer to deliver the broken part to be repaired. As a result, Big Bear Beer's brewery was shut down for an additional five days, and the company lost five days of profits. However, this kind of loss is not a natural and usual result of a simple failure to deliver a broken part to a repair shop on time. In fact, the loss was consequential damages, because it resulted from the special circumstances in this case. Those circumstances were that the part was so important to the brewery that the brewery could not operate without it. Big Bear Beer will be able to recover its lost profits here only if it can show that the carrier Yoeung actually knew about the fact that the entire brewery was shut down because of the broken part. It is unlikely that Big Bear Beer can do this. Big Bear Beer did not tell Yoeung about how important the part was, or what effect the loss of the part was having on the brewery. Yoeung did not learn those facts until after the damage occurred. And a carrier like Yoeung would have no reason to know about the problem unless Big Bear Beer told him. Therefore, Big Bear Beer probably cannot recover these damages from Yoeung.

Of course, Big Bear Beer could recover damages that were reasonably foreseeable. For example, the company probably could recover the difference between what it paid Yoeung for the fast delivery and the reasonable value of the slower delivery. This is because such damage would be a natural and usual result of a breach such as this one (general damages).

Sometimes parties who tend to be in situations like Yoeung in Case Study 238 put clauses in their contracts that expressly limit their liability for consequential damages. Examples of such parties are carriers and photographic film developers. Parties insert such clauses in order to limit their liability for damages that actually were foreseeable. They may also do so

to protect themselves from claims that they actually did know of the special circumstances that led to the damages. For example, Yoeung might have put a clause in his contract with Big Bear Beer that said any remedy for his failure to deliver according to the contract would be limited to the actual replacement value of the item he failed to deliver properly, or some other amount. Likewise, photographic film developers often limit their liability for damage related to film developing to the cost of a replacement roll of film. These clauses, if they are enforceable, may limit a breaching party's liability for damages that actually were reasonably foreseeable.

Of course, such a clause is really a kind of stipulated damages clause. So it is subject to the same kinds of limits that other stipulated damages clauses are, such as limits relating to unconscionability and regulation by statutes. For example, the Uniform Commercial Code in the United States regulates the ability of parties to limit their liability for losses resulting from their breaches of sale of goods contracts. Stipulated damages clauses are discussed in Section 10.5a, above.

Another problem related to whether damages are reasonably foreseeable is whether parties can recover damages for emotional distress caused by contract breaches. In general, it seems that such damages cannot be recovered, since they will not usually be foreseeable, particularly in commercial contracts. However, in some types of contracts, such damages might be foreseeable.

For example, some authorities say that damages for emotional distress might be foreseeable in a contract for funeral services. Suppose a party made a contract to transport a recently deceased person's body from that person's home to the wat as part of the funeral ceremonies. If the transporting party somehow lost or damaged the body, it would probably be reasonably foreseeable that such actions would cause emotional distress to the deceased person's family.

*** ***WHY IS THIS IMPORTANT?*** Why do courts say that parties cannot generally recover damages that the breaching party could not reasonably have foreseen?

There are several important reasons for the rule that damages must be foreseeable in order to be recovered. On the whole, the rule attempts to promote both fairness and a more efficient economy.

One important reason for the rule is that the law feels that it might not always be fair to the breaching party to hold her responsible for all damage caused by a breach, no matter how unforeseeable that damage was. A related reason for the rule is that holding such breaching parties responsible for unforeseeable damages might deter such parties from making certain contracts--such as contracts of carriage--and thus harm the free market economy. Of course, if parties did not have the benefit of this rule,

it might motivate them to perform their contracts more carefully, since the potential unknown risks to them might be so great. But on the whole, it seems that the law does not feel that subjecting parties to this kind of unpredictable risk would be productive.

The rule also helps to motivate parties to think carefully about the risks that may be involved in the performance of a contract, and to plan for those risks to the extent they can. Thinking about these matters may cause one party to tell the other party to the contract about special risks that may not be obvious. That kind of disclosure may actually decrease the risk! That is because the party who becomes aware of the risk may perform the contract more carefully as a result.

For example, in Case Study 238, if Big Bear Beer had actually told Yoeung about the effect that the broken part had on the brewery, Yoeung might have been more careful about delivering the part to the Repair Company on time. That would have been better for both parties, and would also have promoted a more efficient economy and judicial system.

Thinking about these risks may also cause some parties to actually allocate the risk in the contract itself. This might occur through a clause limiting a party's liability for consequential damages. For example, the parties in Case Study 238 could have carefully defined the extent of Yoeung's potential liability for consequential damages in the contract. That might have helped them (and the courts) avoid the dispute they had.

10.6c Parties Cannot Recover Damages That They Could Reasonably Have Avoided

When there is a breach of contract, the injured party must often decide what to do in response to the breach. If that party chooses not to ask a court for a remedy, then the party generally need not avoid damages. But if that party does decide to ask a court for damages, the party will not be able to recover damages that she could reasonably have avoided (or "mitigated"). The reason for this rule, as with the rules above, is that it promotes fairness to the breaching party and efficiency in the economy.

As a practical matter, this rule means that a party should stop her performance of the contract if continuing that performance would increase her losses. On the other hand, in some cases stopping performance would actually increase a party's losses!

The rule may also mean that a party should use reasonable efforts to find a substitute performance at a reasonable price. For instance, this is what Ponnarith did in the form example above, when he used reasonable efforts to find a substitute supplier for the paper following Tahvay's breach. Non-breaching parties often do try to find substitute performances. Such parties may face risks and problems if they do not find a substitute performance.

These include the risk that a court will not determine the real value of the performance in a way that is favorable to such parties, and the risk that they may suffer damages they cannot recover in court. Such parties also may have to spend time and effort arguing in court about what the performance was worth. Many parties wish to avoid those risks.

A party can generally recover the expenses she has in using reasonable efforts to avoid damages--even if those efforts are unsuccessful. For instance, Ponnarith in the example above could probably have recovered his expenses in looking reasonably for a substitute supplier, even if he failed to find one. The important question is whether such a party's efforts were reasonable or not.

This rule about avoiding damages may have different results in different situations. Four of these situations are discussed below.

(1) Sale of Goods -- In sale of goods contracts, either party may generally try to find a substitute performance if a breach occurs. If the buyer breaches, the seller may use reasonable efforts to re-sell the goods. If the seller breaches, the buyer may use reasonable efforts to find substitute goods. In some jurisdictions, if parties fail to use reasonable efforts to find substitute performances, their damages may be limited to the difference between the contract price and the market price of the goods. These rules about sale of goods contracts can be complex. Some of them will be discussed in more detail in Section 10.8a, below.

(2) Construction Contracts -- In construction contracts, where the owner breaches, the builder should generally stop work on the job, unless that would actually increase the damages. The builder should generally stop purchasing supplies, and try to sell or use the materials she has already purchased for the job. If she fails to act reasonably in these ways, she will be unable to recover for damages she suffers that she could reasonably have avoided.

For example, suppose a builder named Monika is hired to build a new part onto Ra's house. Monika buys a lot of equipment and materials for use on the job. But Ra breaches soon after the work starts. Monika will not be able to recover for damages she could reasonably have avoided by selling the equipment or materials, or using them in some other way. Obviously, this also means parties like Monika cannot recover for losses they create themselves simply to increase the damages the breaching party must pay. That might occur if Monika were to actually destroy some of the materials, just to increase the damages Ra would have to pay!

Of course, in some cases, not stopping the construction would be the best way to avoid damages. That might happen if materials or labor would otherwise go to waste, or if the building was in danger of being seriously damaged, if it was left in its unfinished state. So in that kind of case, the builder would be permitted to complete the construction.

(3) Manufacturing Contracts -- Similarly, in manufacturing contracts, where a party for whom a manufacturer is making goods breaches, the manufacturer can generally avoid damages best by stopping her work. However, in some cases, the best way to avoid damages might be to actually finish making the goods. This might occur with partly manufactured goods that would have little or no value unless they were completed. In that situation, completing the goods might actually decrease the manufacturer's damages. So the manufacturer would have the right to complete the goods.

(4) Employment Contracts -- In employment contracts, when an employer breaches a contract by terminating an employee, the employee cannot recover for damages that she could have reasonably avoided by finding another job. However, the employee is not required to take any job at all--no matter how inappropriate for her--in order to avoid damages. Specifically, the employee is not required to take another job that is substantially different from or inferior to the job she lost. In general, the employee should use reasonable efforts to find another job of roughly comparable type, salary, and geographic location.

*** ***CASE STUDY 239***

FACTS Happy Market hired Kruy to work as a sales clerk for one year. Kruy worked at the Market for about six months, and both parties were happy. Unfortunately, at that time, Happy Market told Kruy he had to leave, and paid him no more money. Happy Market did say it would try to help Kruy find another job. But Kruy refused, and kept asking for the money for the six months remaining on his contract.

Kruy brought a lawsuit claiming that Happy Market had breached its contract with him and claiming the remainder of his salary as damages. The court agreed that Happy Market had breached the contract, and began to consider what damages might be appropriate.

Happy Market argued that Kruy had failed to use reasonable efforts to avoid damages. Happy Market provided good evidence that there were sales clerk jobs with similar pay available at the Big Market at the time Kruy was fired, and that Kruy should have been able to get one of those jobs within a month from the time Happy Market asked him to leave. Kruy admitted that he could probably have gotten one of those jobs. But Kruy said those jobs were not comparable because it would have taken him 10 more minutes to get from his house to the Big Market every day.

QUESTION OF LAW Can Kruy recover damages he could have avoided by taking one of the sales clerk jobs at Big Market?

DECISION Probably not. It appears that the job Kruy could have gotten at Big Market was basically comparable to his old job,

and so he probably cannot recover damages that he could have avoided by taking that job.

When an employer breaches an employment contract, an employee can recover only damages that she could not have reasonably avoided. This usually means that she should use reasonable efforts to find other employment of a roughly comparable type, salary and geographic location.

In this case, Happy Market breached its employment contract with the sales clerk Kruy. Kruy did not look for other employment, even though sales clerk positions at similar pay were available at Big Market. Kruy probably will not be able to recover damages that he could have avoided by taking a job at Big Market. This is because the positions available there appear to be roughly comparable as to type, pay, and geographic location. The fact that Big Market would require a little longer trip to work each day is probably not enough for a court to find that the Big Market jobs were substantially different or inferior. So Kruy could probably not recover damages he could have avoided by taking that job. The damages he could have avoided would probably include most or all of the pay he could have earned during the last five months of his contract with Happy Market. Of course, Kruy could recover damages that he could not have avoided. Such damages would include the pay for the one month that Happy Market's evidence showed it would probably have taken him to find the job at Big Market.

Although Kruy was unable to recover damages he could have avoided by taking the other sales clerk job in Case Study 239, it is important to remember that parties are not required to take any job they can find in order to avoid damages. Suppose Kruy had been unable to find any other job except that of selling gasoline along the side of the road, at a salary ten times less than his sales clerk salary. A court would probably say that was not comparable employment, and that Kruy would not be required to take that job in order to avoid damages. In that situation, Kruy could probably recover damages for his lost wages until he could reasonably have found a comparable job.

10.7 Courts May Order or Allow Non-Monetary Remedies

Sometimes courts resolving contract disputes decide to order or allow a remedy other than money damages. Courts may do this for a variety of reasons. These reasons include the type of contract involved, the type of dispute that has occurred between the parties, and the positions of the parties involved in the particular case.



This Section explains some of the more important non-monetary remedies that courts may decide to order or allow. In particular, this Section discusses:

(1) specific performance (Section 10.7a);

(2) rescission (Section 10.7b);

(2) reformation and severance (Section 10.7c);

and (3) other remedies courts may order or allow (Section 10.7d).

10.7a Courts May Order Specific Performance of the Contract, Although They Do So Only in Certain Situations

Sometimes courts decide to actually order that a party perform a contract. In these cases, instead of ordering a party to pay money damages to another party, the court simply orders the party to perform the contract, such as by actually delivering the goods she promised to deliver in a sale of goods contract. In many jurisdictions, this is called an order for specific performance.

*** **DEFINITION:** An **order for specific performance** occurs where a court orders a party to actually perform according to the terms of a contract.

An effective order of specific performance may actually achieve the goal of expectation damages better than expectation damages do! This is because an order for specific performance may place the injured party closer than damages will to the exact position she would have occupied if the parties had fully performed the contract. Of course, even if an injured party gets expectation damages and buys a substitute performance, that substitute performance will not give the injured party exactly what she was promised in her original contract: complete performance by the breaching party. But an order of specific performance could nearly provide that, except that the performance would generally be late.

Courts in different jurisdictions apply the remedy of specific performance in different situations. It appears that specific performance is available in civil law jurisdictions in more situations than it is in common law jurisdictions. In fact, in civil law jurisdictions such as Germany, specific performance is considered to be one of the most important types of remedies courts order. However, it appears that such jurisdictions will not order parties in contract disputes to actually perform personal services. It also seems that damages remedies are growing more common in commercial contract cases in civil law jurisdictions.

In common law jurisdictions, courts prefer to order the remedy of money damages in most cases. In these jurisdictions, specific performance is ordered

only in limited situations. In particular, many common law jurisdictions say it should be ordered only where a court believes that:

(1) money damages are not adequate to compensate the injured party;

AND (2) the court can adequately enforce the order of specific performance.

With regard to the first requirement, common law courts feel that damages may not be adequate in some situations because the subject matter of the contract is unique. This often means that the injured party cannot get the benefit of what she was promised under the contract unless she actually gets the promised subject matter from the other party to the contract. The two most important situations where this may occur are contracts for the sale of land, and contracts for the sale of unique goods. These will be discussed later in this Section. Other situations in which the subject matter might be unique are contracts for the sale of patents, copyrights, or businesses, and contracts that involve promises not to do something, such as promises not to compete. In these cases, damages might not be adequate.

The second requirement is that common law courts must believe that they can adequately enforce the order. Obviously, courts feel that they can adequately enforce certain orders, such as orders for the payment of money, or the transfer of property. But many courts feel they will have difficulty enforcing orders that are more complex or likely to lead to problems, such as orders for the performance of personal services. It appears that many courts may also require that the terms of a contract be more clear and definite in order for them to order specific performance. This requirement exists so that courts are able to make sufficiently specific orders, and able to tell whether those orders are being obeyed.

Because many common law courts do not order specific performance unless the two requirements above are met, there are not many situations where they actually do order specific performance! As noted above, the two most important ones are in cases involving the sale of land and the sale of unique goods. In both of these situations, damages may not be adequate. That is because a buyer of such unique items cannot use money to get a truly comparable performance anywhere else. Common law jurisdictions believe that no two pieces of land are truly the same. They also believe that no two sets of truly unique goods--like unique works of art--are the same. In addition, in both situations, it is generally not too difficult to supervise the transfer of land or goods from one party to the other.

Here is an example of a situation where a court might order specific performance of a land sale contract. Suppose Chhoeun agrees to sell a particular piece of land to Sarin. Chhoeun breaches the contract and refuses to sell the land to Sarin, and Sarin requests specific performance. A common law court would be likely to order that Chhoeun specifically perform

the contract. Damages would probably not be adequate to compensate Sarin for the breach, since Sarin cannot buy that particular piece of land from anyone but Chhoeun. And supervising this kind of order for specific performance should not be too difficult for a court. It is probably not difficult to determine whether or not Chhoeun has transferred the land to Sarin.

An example of a sale of goods contract that might be appropriate for specific performance in common law jurisdictions would be if Chhoeun agrees to sell Sarin a painting of Angkor Wat done several years earlier by a famous artist. Suppose that, after the contract is made, Chhoeun changes his mind and refuses to sell the painting. In that case, a court might order specific performance. The reason is that damages would not be adequate to compensate Sarin for the loss he would suffer because of the breach. No amount of money can adequately replace an original work of art. And again, it is not too difficult for a court to supervise this performance, which merely involves the transfer of a piece of personal property.

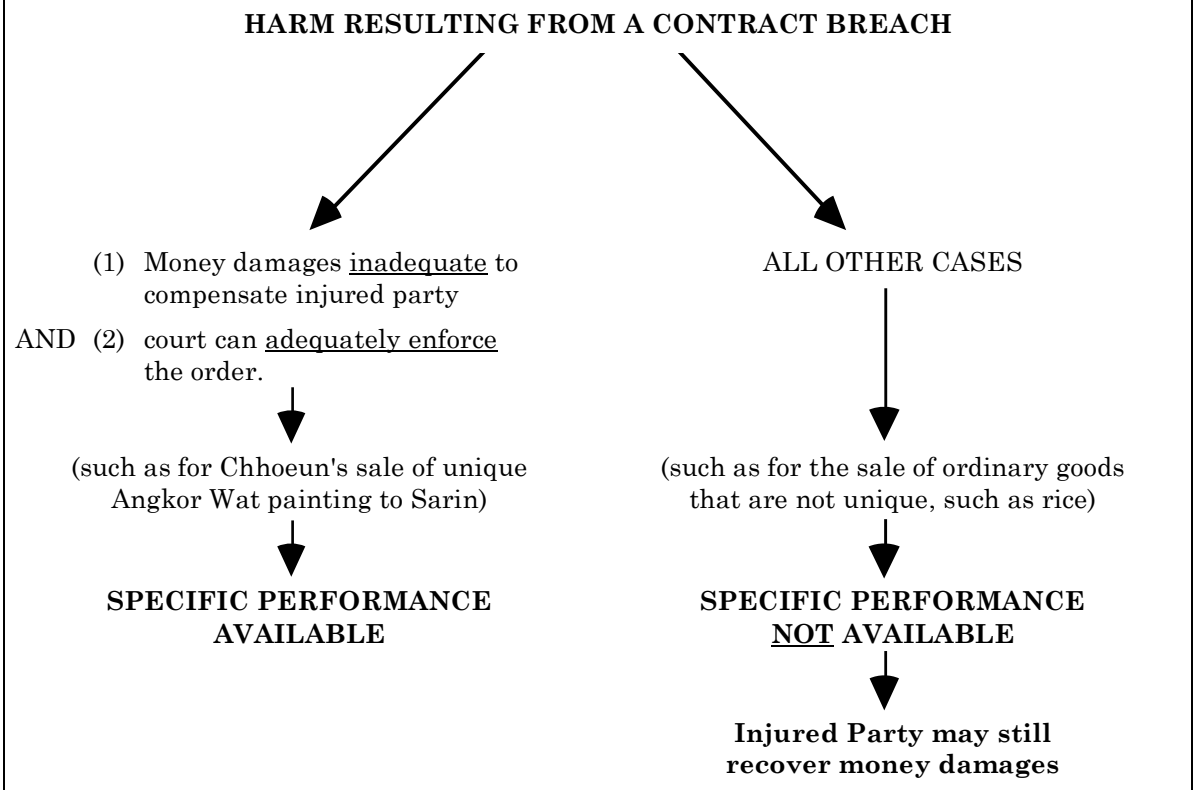
However, most common law courts are very unlikely to order specific performance of a contract for the sale of goods that are not unique. The Uniform Commercial Code in the United States provides for specific performance where goods are unique or in "other proper circumstances." These other circumstances appear to be rare. For example, suppose there is a breach of a contract for the sale of rice. Rice is one of the least unique goods in the world. In general, anyone with money can buy rice. Most common law courts feel that damages should be adequate to compensate a buyer injured by a contract breach in that situation. By contrast, it appears that civil law courts like those in Germany might order specific performance even for common goods such as rice.

One situation in which some common law jurisdictions may order specific performance in sale of goods contracts even if the goods are not really "unique" is where the injured party cannot find replacement goods anywhere else. This might occur because of the current state of the market. For example, it might happen with regard to the supply of large quantities of oil or gas under a long-term requirements contract. In that kind of situation, the buyer might have difficulty finding a substitute performance in the event of a breach. A buyer might have such difficulty because the market is too uncertain or chaotic at a particular time.

The chart below illustrates when many common law courts will order specific performance in a contract dispute.



Illustration: When Many Common Law Courts Order Specific Performance



The practical result of the above rules is that, in most situations, common law courts will not order specific performance. For example, such courts are very reluctant to order specific performance of contracts for personal services or construction contracts. In these kinds of situations, the subject matter of the contract may or may not be unique. However, the difficulties in enforcing these kinds of orders seem to be the main reason that courts will not usually make them. It might be very difficult for a court to supervise the performance of a large, complex construction contract. Likewise, ordering a party to perform a personal services contract that she does not wish to perform could lead to many serious problems. This is true whether the breaching party is the employer or the party providing services. It appears that even civil law jurisdictions will not make such orders in these cases. In fact, some courts have even compared ordering workers to supply such services to involuntary servitude! For example, an employee who was ordered to work for an employer she hated might suffer great mental and other damage. She might also start to consider inappropriate responses to such an order. Courts wish to avoid such results.

*** ***CASE STUDY 240***

FACTS Suppose the facts of Case Study 237 happen in a somewhat different way. The Royal Dance Company and a dancer named Vannrath

make a contract under which Vannrath agrees to dance the part of the apsara in the biggest dance performance of the year. Unfortunately, only two weeks before the performance, Vannrath makes an anticipatory repudiation. The Dance Company is unable to find anyone else to perform the part on such short notice.

Suppose the Dance Company realizes that it will have trouble proving expectation damages, because of the uncertainty about the amount of profits it will lose because of Vannrath's breach. Not long before the performance is scheduled to occur, the Dance Company goes to court and asks for an order compelling Vannrath to actually dance in the performance--an order for specific performance.

QUESTION OF LAW Will a court order Vannrath to actually dance in the upcoming performance of the Royal Dance Company?

DECISION No. A court will not order Vannrath to actually dance in the performance of the Dance Company, because that would be an order for specific performance of a personal services contract.

Courts will almost never order parties to specifically perform personal services contracts. Common law jurisdictions will not usually make such orders because, even if a party can show that damages are inadequate, the party is very unlikely to be able to show that the court will be able to enforce the order adequately.

In this case, Vannrath breached her contract to dance for the Royal Dance Company, and the Company will almost certainly be harmed as a result. The Company fears it cannot prove expectation damages, so it asks a court for an order of specific performance. A court is extremely unlikely to grant such an order, because this is a personal services contract.

The Company can probably meet the first common law requirement for such an order, that damages are inadequate, by showing that Vannrath's services are unique. They probably are unique, since she is a highly skilled dancer and the Company has been unable to find any other dancer to dance the part on such short notice.

However, the Dance Company will not be able to meet the second requirement, which is that the court be able to enforce adequately the order of specific performance. This is a personal services contract, and one in which the parties will probably have strong negative feelings for each other by the time of any such performance a court might order. This could lead to many problems in the enforcement of an order for specific performance. In addition, the subject matter of the contract is an artistic performance. It will be very difficult for a court to measure whether Vannrath is really complying with the contract if it orders her to perform. On the whole, it would be very difficult for a court to enforce adequately an order for specific performance

in this situation. So a court is unlikely to make such an order. Of course, as noted above, the Company might at least try to recover its reliance or restitution damages.

One thing a court might order in a personal services situation would be that a breaching worker not perform those services for anyone else during the term of the contract. This kind of court order--an order not to do something--is called an injunction. However, it seems that such injunctions are available only in very limited circumstances. Some courts make such orders only where the services involve unique skills; the injunction would leave the worker with some other reasonable way to make a living; and, if it seems that the injunction will probably influence the worker to actually perform the original contract, it appears that the worker will perform it in good faith.

*** ***WHY IS THIS IMPORTANT?*** Why do courts in common law jurisdictions order specific performance only in the limited situation where they believe that damages are inadequate and that they can adequately enforce the order?

One basic reason common law courts order specific performance only in these limited situations is that they are generally reluctant to order parties to do extensive activities they do not wish to do, or may be unable to do. For example, the law in these jurisdictions does not wish to force persons to perform services they do not wish to perform. In fact, if a court made such an order, it might also lead to even more serious problems in performance, possibly including a breach of the peace or other criminal acts. This is because many people who are involved in legal disputes against each other find it difficult and unpleasant to continue to work together after the dispute. And even in sale of goods contracts, common law jurisdictions seem to feel that it would not be productive to try to force parties to perform, unless there was a special reason, such as that the goods were unique. Even though such contracts may not involve much contact between the parties, the law may feel that even such minimal contact is not worthwhile where damages can adequately compensate the injured party.

In addition, it might be very difficult for a court to continually supervise the performance of many kinds of contracts. It is much easier to enforce a court order for money damages or transfers of property than an order that requires a party to perform some other tasks. It may be difficult to judge if the other parties to such contracts are performing properly, especially in contracts involving services, such as the highly skilled dancing involved in Case Study 240. Of course, courts must often make this kind of decision in order to determine if a contract was breached! But perhaps they wish to avoid it if they can, or avoid spending their time supervising complex tasks as they are happening. That might leave the court with more time to decide other cases.

Another reason specific performance is not usually ordered might be that, in some cases, courts do not wish to stop parties from performing

other contracts they have made. This was already discussed in Section 10.5d, above, which dealt with punitive damages for bad faith breaches, and explained the idea of "efficient breach." As noted above, in some situations the law may actually not wish to stop such parties from breaching certain contracts and making others! Some authorities appear to feel it may be economically more efficient if parties such as Better Homes in Case Study 211 do sometimes breach their contracts when they get a better opportunity. As the reader will recall, Better Homes breached its contract to build homes for the Queen Group in order to perform a much bigger contract with the Big White Villa Company. A better opportunity like that often means that parties like Better Homes can do more business, and create more wealth and economic activity. This may seem unfair to the Queen Group. Of course, courts generally try to put parties like the Queen Group in the situation they would have occupied if the contract had been fully performed, by ordering expectation damages.

On the other hand, as noted above, an effective order of specific performance may get closest to what the injured party was actually promised under the contract. Such an order may come closest to placing that party in the position she expected to occupy if the contract had been fully performed--which is the real goal of expectation damages. Apparently civil law courts may order specific performance of contracts in a much broader range of situations, including the sale of commonly available goods, though they will not order parties to perform personal services. It would not seem to cause substantially greater bad feelings to simply order a party to deliver goods than it would to order the party to pay money. So orders for specific performance might be appropriate and effective in more situations than common law jurisdictions use them. What do you think?

10.7b Courts May Order or Allow Rescission of the Contract

Another non-monetary remedy courts may order or allow is rescission. As explained in several Chapters above, rescission is basically the cancellation of a contract. Rescission is likely to be used where a contract has resulted from a formation problem like mistake, duress, or misrepresentation, or where one party has materially breached the contract. When a court allows a party to rescind, the court will generally provide a party with restitution of the benefits she has given to the other party, to the extent needed to prevent unjust enrichment. Rescission has already been explained in detail in Chapter 9 ("Performance and Discharge of Duties"), Section 9.7a.

In general, parties may or may not need the assistance of a court order where they have mutually rescinded a contract. But in the case of unilateral rescission, it seems more likely that a party may need the assistance of a court in order to get restitution after her cancellation of the contract.

*** ***CASE STUDY 241***

FACTS Chantha and Sareth agree that Sareth will sell 500 eggs to Chantha for $30. The contract requires that Chantha pay $10 one day before the eggs are delivered, and $20 at the time of delivery.

Chantha makes the first payment. But Sareth breaches the contract by failing to deliver the eggs. Chantha tries to persuade Sareth to perform, but she fails. So Chantha rescinds the contract, and asks Sareth for her $10 back. But Sareth refuses to give the money back, saying he may perform some time. So Chantha asks the court for help.

QUESTION OF LAW Will the court order Sareth to return the $10 to Chantha?

DECISION Yes. The court will order Sareth to return the $10 to Chantha, because she had the right to rescind the contract, and also the right to restitution of what she had provided to Sareth as part of the contract.

Parties have the right to rescind contracts when the other party commits a material breach. In that situation, the rescinding party also has the right to restitution of what she has provided to the other party, to the extent needed to avoid unjust enrichment. In this case, Sareth materially breached his contract with Chantha by failing to deliver 500 eggs to her as the contract required. Chantha has the right to rescind the contract. She also has the right to restitution of the $10 she gave to Sareth, since otherwise Sareth would be unjustly enriched. The court will order Sareth to pay Chantha $10.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.7a, Chapter 7 ("Other Contract Formation Problems"), Section 7.3c, and Chapter 9 ("Performance and Discharge of Duties"), Section 9.7a discuss situations where courts may order or allow rescission.

10.7c Courts May Order Reformation or Severance of the Contract

As explained elsewhere, the basic rules of contract law do not allow courts to "rewrite" contracts. The reason is that courts generally wish to let parties make and perform their own agreements, without any interference. However, in a few limited circumstances where there are contract formation problems, courts may actually be able to reform agreements, or sever parts of them, and then enforce what remains. The practical result is that the court will enforce the altered contract like any other contract, and that the full range of remedies discussed in this Chapter might be available.

When a party asks a court to sever or reform part of an agreement, the basic question is whether the court can fairly and effectively enforce the agreement between the parties after the reformation or severance occurs. If the answer is yes, then the court may generally enforce

the changed agreement. But obviously, this often impossible, as it generally is with problems related to real agreement, consideration, capacity, and in many cases legality.

In general, formation problems where reformation or severance may be possible seem to relate to legality, unconscionability, or mistake. The rules about exactly when a court may reform or sever parts of agreements vary in different circumstances, as discussed in preceding Chapters. The following are examples of situations where some courts may order that an agreement be enforced after a change to some part that is affected by a formation problem:

(1) courts might enforce a usurious loan agreement at the maximum legal interest rate;

(2) courts might enforce a non-competition clause in a contract for employment or the sale of a business, but only to the extent of a reasonable restraint;

(3) courts might reform a written agreement that does not correctly reflect the real prior oral agreement of the parties because of a mistake;

(4) courts might enforce an adhesion contract without a part such as an exculpatory clause that a reasonable weaker party would not have expected and to which she would not have agreed; and

(5) courts might enforce agreements without unconscionable parts if those parts can be effectively severed.

*** ***CASE STUDY 242***

FACTS Kimhok and Sok Y sign a written agreement in which Kimhok agrees to buy Sok Y's farm in Kompong Thom. Sok Y owns only one farm. The boundaries of the farm are clearly marked, and Kimhok and Sok Y both understand where they are. The parties try to record these boundaries as precisely as they can in their contract. The contract says that Kimhok is buying Sok Y's farm in Kompong Thom.

Unfortunately, when Kimhok goes to give Sok Y the money for the land, Sok Y refuses to give him the title to the land! Sok Y shows him the agreement, and explains that, because of a mistake the parties made, it actually does not describe accurately the boundaries of Sok Y's farm. In fact, it describes a piece of land that includes part of Sok Y's farm and part of his neighbor's farm.

Sok Y says the agreement cannot be enforced, and anyway he does not want to sell anymore at the price in the agreement, since changes in the real estate market have made his land more valuable. Kimhok asks the court to reform the agreement to reflect the parties' real intentions when they made it, and to enforce the agreement.

QUESTION OF LAW Will the court reform the agreement for the sale of Sok Y's land to reflect the correct boundaries of his farm and enforce the agreement?

DECISION Yes. The court will reform the agreement to reflect the true boundaries of Sok Y's farm and enforce the agreement, since the written agreement did not reflect the real agreement of Sok Y and Kimhok, because of a mutual mistake.

Where a written agreement does not accurately reflect the real prior agreement of the parties because of a mutual mistake, the court may be able to reform and enforce the agreement, as long as that can fairly and effectively be done. In this case, Sok Y and Kimhok made a mistake in recording the correct boundaries of Sok Y's farm in the agreement in which Sok Y was to sell the farm to Kimhok. Despite the mistake, it was clear from the rest of the contract and other evidence that the parties meant the contract to be for the sale of Sok Y's farm. The court will reform the written agreement to reflect the real agreement, and enforce the reformed agreement. In this case, Kimhok could probably choose to ask for either money damages or specific performance.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.3c discusses usurious loan agreements, Section 5.4f discusses non-competition clauses, Section 5.4g discusses exculpatory clauses, and Section 5.5b discusses the general effects of severance or reformation of contracts; Chapter 7 ("Other Contract Formation Problems"), Section 7.3 discusses mistake, and Section 7.7c discusses unconscionability; and Chapter 9 ("Performance and Discharge of Duties"), Section 9.4k discusses severance with regard to contract performance.

10.7d Courts May Order or Allow Other Remedies

There are a variety of other non-monetary remedies that may be available to courts or parties in particular situations. Some of these are briefly described below.

In some cases, restitution may involve a court ordering a party to actually return a particular benefit that another party has provided to her, rather than merely paying the reasonable value of that benefit. This is called specific restitution. In general, a court may order this if the party who has provided the benefit requests it and the benefit can easily be returned. Perhaps the most important situation where this may occur is where a party seeks specific restitution of land after the other party breaches a land sale contract, or after deciding to avoid the contract because of some formation problem.

*** ***CASE STUDY 243***

FACTS Suppose the facts in Case Study 242 happen in a different way. In this new case, Sok Y agrees to sell his farm only after Kimhok tells him that a big company will soon be building a factory on the property next to the farm. Sok Y does not want to live next to this factory. So he agrees to sell the farm to Kimhok at a low price.

Soon after the parties have performed the contract, Sok Y discovers that there will be no factory, and that Kimhok knew that when he told Sok Y about the factory. Sok Y gives the money back to Kimhok, and asks for the farm back. Kimhok refuses to give it back. Sok Y asks the court for help.

QUESTION OF LAW Will the court order Kimhok to return the farm to Sok Y?

DECISION Probably. The court will probably order specific restitution of the farm to Sok Y, since Sok Y sold the farm because of Kimhok's misrepresentation about the factory.

Courts may order specific restitution where a breach or formation problem entitles a party to restitution, and where the benefit given to the other party can easily be returned. In this case, Kimhok made a material misrepresentation to Sok Y about the construction of a factory next to Sok Y's farm, and Sok Y justifiably relied on that statement in selling his farm to Kimhok. This entitles Sok Y to avoid the contract and ask for restitution. In this case, the court will probably order the specific restitution Sok Y seeks, since the benefit here--Sok's farm--can easily be returned.

In addition, the contract itself may stipulate that a party has or does not have certain non-monetary rights. For example, a contract may say that a buyer of goods has the right to repair or replacement of a non-conforming product. Or it may provide that a buyer has that remedy if the goods fail to work, but no other remedies! This is comparable to stipulated damages clauses, which were discussed in Section 10.5a, above.

Contracts may also try to limit the remedies of a party through exculpatory clauses. Of course, many jurisdictions say such clauses are not enforceable if they are unconscionable or in violation of statutes. This was already discussed in Chapter 5 ("Legality"), Section 5.4g, and Chapter 7 ("Other Contract Formation Problems"), Section 7.7.

A party may be able to use the remedy of withholding her performance of a contract duty if a condition on which that duty depends fails to occur. Parties may also gain other rights when there is some problem in the performance of contracts. For example, where there is a prospective unwillingness or inability to perform, laws in many jurisdictions say that the other party gains the right to demand adequate assurances of performance

from the party whose performance seems unlikely. Conditions and performance were discussed in detail in Chapter 9 ("Performance and Discharge of Duties").

The law in some jurisdictions may provide for other remedies in specific kinds of cases. For example, in some jurisdictions, laws may change the remedies available to buyers and sellers in sale of goods contracts. For instance, such laws may describe the circumstances in which buyers may reject a performance, withhold their own performance, demand adequate assurances of performance, or ask the other party to cure her performance. Some of these problems were already discussed in Chapter 9, Section 9.5b, which explained performance of sale of goods contracts. These and some other remedies for specific kinds of cases will be further discussed in Section 10.8, below.

*** ***ADDITIONAL REFERENCE:*** Chapter 5 ("Legality"), Section 5.4g discusses the enforceability of exculpatory clauses; Chapter 7 ("Other Contract Formation Problems"), Section 7.7 discusses the nature and effects of unconscionability; and Chapter 9 ("Performance and Discharge of Duties") discusses performance and the effect of conditions, including Section 9.4e's explanation of prospective inability or unwillingness to perform.

10.8 Remedies in Particular Situations

As noted in Section 10.7d above, the law in some jurisdictions provides that certain remedies are available to parties in particular situations. In many jurisdictions, sale of goods contracts are probably the most important type of contracts that are affected in this way. An example of the range of potential remedies provided by one statute for sale of goods contracts will be discussed in Section 10.8a. In addition, the law may specify what kinds of remedies are available in cases where courts find quasi-contracts, as discussed in Section 10.8b, and in cases where courts apply the doctrine of promissory estoppel (detrimental reliance), as discussed in Section 10.8c.

10.8a Remedies in Sale of Goods Contracts

Statutes in many jurisdictions provide for an extensive set of special remedies for the parties to sale of goods contracts. One example is the Uniform Commercial Code ("UCC") in the United States. The remedies provided by the UCC can be very complex. This text will examine only a few of the more important ones below.

This text has already discussed certain rights of parties to sale of goods contracts. Chapter 9 ("Performance and Discharge of Duties"), Section 9.5b discussed the right of a buyer to reject non-conforming goods or to revoke her acceptance under the UCC. In addition, Section 10.2 of this Chapter discussed

methods of calculating expectation damages where parties breach sale of goods contracts.

The UCC also provides specific remedies to the seller where the buyer breaches the contract. Suppose a buyer breaches without finally accepting the goods. This could occur where the buyer repudiates, fails to pay before acceptance if the contract requires it, wrongly rejects, or wrongly revokes her acceptance. In those situations, the seller may resell the goods. If the resale is made:

(1) in good faith,

(2) in a commercially reasonable manner,

and (3) in accord with other UCC requirements,

then the seller may recover:

(1) the difference between the resale price and the contract price,

plus (2) incidental expenses the seller had in performing the resale,

minus (3) any damages the seller could reasonably have avoided.

If the seller does not resell in this way, then she can recover:

(1) the difference between the contract price and the market price at the time and place of tender,

plus (2) incidental expenses,

minus (3) reasonably avoidable expenses.

In cases where neither of these remedies will really provide the seller with her true expectation damages, the seller may ask for her lost profits in failing to make the sale to the buyer who breached--even if she re-sold the goods for the same price! This might occur where the seller actually depends on "volume sales" (meaning high volume sales) for her profits. Often sellers--such as many retailers, wholesalers, and manufacturers--sell as many as they can of the goods they sell. If they lose one sale because of a buyer's breach, they can often re-sell the goods to another buyer for basically the same price. But they would have sold to that second buyer anyway! So their real losses actually include the profit they would have made from the sale to the breaching buyer. In this situation, the UCC allows the seller to recover such lost profits.

For example, suppose a truck dealer normally sells new trucks for $30,000 each, a price which includes a $4,000 profit for the dealer on each truck sold. If one buyer breaches, the dealer can probably sell that truck to another buyer for about the same price, which would seem to mean her expectation damages are almost nothing. But in fact, the dealer has lost all

the profits she would have made on the sale to the breaching buyer. The dealer would have sold a truck to the new buyer anyway, but she will probably never sell to the breaching buyer. The UCC would probably allow the dealer to recover the $4,000 in lost profits.

Finally, under the UCC, the seller may be able to recover the full contract price in three situations:

(1) if the buyer accepted conforming goods;

(2) if the goods were destroyed after the risk of loss passed to the buyer;

or (3) if the goods are "identified to the contract" and the seller cannot resell them at a reasonable price.

"Identified to the contract" basically means the seller has decided that a particular set of goods is the set she will supply to the buyer under the contract. Apparently the seller cannot recover the "consequential" damages that occur because of "special circumstances" like those discussed in Section 10.6b above--damages that do not occur naturally and usually from breaches like these. However, it would appear that a seller of goods would rarely have such damages.

******* ***CASE STUDY 244*** **(U.S. commercial code)**

FACTS Sara makes a contract to sell a certain quantity of preventative health care books to Mony for $1,000. Payment is to occur at the time of delivery. However, when Sara delivers the books, Mony wrongly rejects them, claiming they are not the correct books.

Sara promptly and reasonably resells the books to a different buyer for $950. She also has expenses of $30 in finding this new buyer. After re-selling the books, Sara asks Mony to compensate her for her lost profits and incidental expenses. Mony refuses. So Sara asks the court for help.

QUESTION OF LAW Can Sara recover her lost profits and incidental expenses in this situation?

DECISION Yes. After Mony's breach of the contract, Sara re-sold the books in good faith and in a commercially reasonable manner, so she can recover her lost profits and incidental expenses, which in this case would be $80.

When a buyer breaches a sale of goods contract by wrongly rejecting the goods, the seller may re-sell the goods. If she does re-sell in good faith, in a commercially reasonable way, and in accord with other UCC requirements, then she can recover the difference between the contract price and the re-sale price, plus any incidental expenses, minus any damages she could reasonably have avoided.

In this case, Sara made a contract to sell Mony preventative health care books for $1,000. But Mony wrongly rejected the books Sara delivered. Sara promptly and reasonably re-sold the books for $950, and had $30 in incidental expenses in finding the new buyer. Sara acted in good faith and in a commercially reasonable manner, and in accord with other UCC requirements. She avoided all unnecessary damages. So she will be able to recover the difference between the contract price ($1,000) and the re-sale price ($950), which is $50, plus her incidental expenses, which are $30. So she can recover a total of $30 plus $50 = $80 from Mony because of the breach.

The UCC also provides several remedies to the buyer where the seller breaches the contract. If the seller breaches the contract and the buyer does not accept the goods--whether because the seller repudiates, or because the buyer rightly rejects or revokes acceptance--then the buyer may choose to "cover," which means to find and buy substitute goods. If the buyer covers by:

(1) making a reasonable purchase of substitute goods,

(2) in good faith, and

(3) without unreasonable delay,

then the buyer may recover:

(1) the difference between the cost of the cover and the contract price,

plus (2) incidental and "consequential" damages,

minus (3) reasonably avoidable damages.

In fact, as long as the cover is made in good faith, the price of the cover goods need not even be the lowest price available! In addition, the goods are not required to be exactly the same as those in the contract, if that is justified by the circumstances. Consequential damages were discussed in detail in Section 10.5b above, which explained the requirement that damages be reasonably foreseeable in order for parties to recover them.

If the buyer does not cover in this way, then the buyer may recover:

(1) the difference between the contract price and the market price at the time the buyer learned of the breach,

plus (2) incidental and consequential damages,

minus (3) reasonably avoidable damages.

If the buyer accepts non-conforming goods, she may recover the difference between the actual value of the goods and the value the goods would have had if they were conforming, all measured at the time and place of acceptance.

******* ***CASE STUDY 245*** **(U.S. commercial code)**

FACTS Suppose the events in Case Study 244 happened in a different way. As in Case Study 244, Sara makes a contract to sell a certain quantity of preventative health care books to Mony for $1,000. Mony tells Sara that he needs the books at exactly the time of delivery for a short course he will be teaching, though he will also need them for a long time in the future. Payment is to occur at the time of delivery. However, when Sara delivers the books, Mony rightly rejects them, because they are not the correct books. In fact, they are law books, which Mony hates.

Without delay, Mony looks for other health care books. But at first he cannot find any that are similar enough to the ones Sara agreed to sell him. He cannot find any in time for his course. As a result, he loses $50 in course fees of students who do not wish to study without materials.

Mony eventually finds books that are basically similar to the ones Sara had agreed to sell him, and buys those in good faith for $1,100, which is a reasonable price. Mony also has $30 in incidental expenses in covering in this way. He asks Sara to compensate him for the amount he lost because of the breach. Sara refuses. Mony asks the court for help.

QUESTION OF LAW Can Mony recover the amount he lost because of Sara's breach in this situation?

DECISION Yes. After Sara's breach, Mony covered by finding similar goods in a reasonable way, so he will be able to recover the difference between the contract price and the cover price, plus any incidental and consequential damages, which in this case would be $180.

When a seller breaches a sale of goods contract, the buyer may attempt to cover by finding other goods to substitute for the ones in the original contract. If she does cover by making a reasonable purchase of substitute goods without unreasonable delay, she can recover the difference between the contract price and the cover price, plus any incidental or consequential damages, minus any damages she could reasonably have avoided. This is true even if the cover goods are not purchased at the lowest price available, as long as the cover is in good faith, and even if the cover goods are not exactly the same as the goods in the original contract, if the circumstances justify it.

In this case, Sara breached the contract for the sale of preventative health care books by delivering law books, and Mony rejected them. Mony covered in good faith and in a reasonable way. Mony suffered incidental damages of $30 in finding the substitute goods, and consequential damages of $50 because of the lost course fees, which were reasonably foreseeable because Mony had told Sara about the special situation that caused them. Mony also had to pay $1,100 for the substitute goods, which were similar to but not exactly the same as the original contract goods. In this situation,

Mony will be able to recover the difference between the cover price ($1,100) and the contract price ($1,000), which is $100, plus her incidental expenses, which are $30, plus her consequential damages, which are $50. This means that Mony can recover $100 plus $30 plus $50, for a total of $180.

The UCC provides that the buyer may get specific performance of a sale of goods contract where the goods are unique or in "other proper circumstances." The "other proper circumstances" language would allow a court to order specific performance in a situation where market conditions would prevent a buyer from making a comparable contract. This language might also allow a court to order specific performance in other circumstances. Specific performance was already discussed in detail in Section 10.7a above.

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties"), Section 9.5b further discusses performance of sale of goods contracts, and options parties have when there is some problem with performance.

10.8b Remedies Where Courts Find a Quasi-Contract

As discussed above, quasi-contract is basically a doctrine courts apply when they impose contract obligations in order to avoid unjust enrichment of a party. In fact, a court may find that a quasi-contract exists where the parties do not even attempt to make a real agreement! A quasi-contract may also occur where the parties do attempt to make an agreement, but the agreement is unenforceable for some reason, such as a lack of formality, mistake or other formation problems.

As explained in Section 10.4 above, where courts find a quasi-contract exists, they will generally award restitution, in order to prevent unjust enrichment of a party. This is the most common type of remedy in quasi-contract cases, because the common goal of both restitution and quasi-contract is to prevent unjust enrichment of a party. Restitution generally involves the court ordering one party to give another party the reasonable value of the benefit that the first party received from the other party. Specific restitution is also possible where the benefit can be easily given back to the party seeking it, as explained in Section 10.7d, above.

Although restitution is the most common remedy in the event of a quasi-contract, it appears that courts may also occasionally order reliance damages in particular cases. This might occur where the enrichment is difficult to measure, or where providing only restitution will not achieve justice.

For example, in the Case Study 23 situation, suppose Lam was on holiday when a rain storm threatened to destroy his house. Chito saw what was happening, but he could not contact Lam to tell him about the problem in time. Finally, Chito had to spend his own money to fix Lam's house and prevent it from collapsing.

In that situation, a court would be likely to find a quasi-contract between Chito and Lam, in order to prevent unjust enrichment of Lam--even though the parties never made a real agreement. The damages a court would probably order Lam to pay would be the reasonable value of the benefit Chito gave to Lam in fixing his house--the value of his services--which would be restitution.

However, suppose Chito also had to buy tools to do the work. That expense might not normally be considered part of the "enrichment" of Lam. But it might still be unjust to require that Chito pay for all of the tools himself. In that situation, a court might consider ordering Lam to pay for some or all of the tools Chito bought--which would be more like reliance damages.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.5 and other Chapters in this text contain further discussion of quasi-contracts.

10.8c Remedies Where Courts Apply Promissory Estoppel (Detrimental Reliance)

Sometimes parties change their position--such as by spending money--in reliance on promises made by other parties, even when there is no enforceable contract. When this occurs, many common law jurisdictions may apply the doctrine of promissory estoppel (detrimental reliance). Under promissory estoppel, a promise may be enforceable to the extent needed to prevent injustice if a party justifiably relied on it and the party who relied will suffer an unjust loss if the promise is not enforced. This was discussed in detail in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

When courts apply the doctrine of promissory estoppel, it appears that they will generally order that reliance damages for the party who relied. The reason is that the whole idea of promissory estoppel is to compensate a party for her reasonable reliance on a promise. If courts ordered only restitution, they would not always achieve this goal, since parties often have reliance damages without actually giving any benefit to the other party.

For example, in Case Study 176, Ken sold his house, quit his job, and moved to Battambang in reliance on Margo's promise to give him a new job. In that situation, Ken reasonably relied and suffered reliance damages--but he conferred no benefit on Margo. So awarding him restitution would probably not achieve justice.

It also appears possible that courts might order expectation damages when they apply promissory estoppel. For example, some authorities appear to think such damages might be appropriate if the party who made the promise did not act in good faith. However, such cases would seem to be unusual.

Finally, in rare cases, it also seems possible that specific performance could be an appropriate remedy where promissory estoppel applies. For example, in Case Study 175, Kosal justifiably relied on his parents' promise to transfer their farm to him. Since land is unique, and even common law courts will order specific performance for land cases, a court might decide that ordering specific performance in this situation was the only way to achieve justice for Kosal.

*** ***ADDITIONAL REFERENCE:*** Chapter 2 ("Real Agreement (Offer and Acceptance)"), Section 2.4e, and Chapter 7 ("Other Contract Formation Problems"), Section 7.8 contain further discussion of promissory estoppel.

10.9 Remedies in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the Cambodian law tradition and the civil law tradition to remedies appear to be generally compatible with the approach discussed in this Chapter. However, specific performance seems to be more commonly used in civil law jurisdictions than it is in common law jurisdictions, and civil law jurisdictions may be somewhat more willing to order contract remedies that may be viewed as punitive than common law jurisdictions are.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) and other Cambodian laws contain a number of provisions relevant to our discussion of remedies. They seem generally compatible with the remedies discussed earlier in this Chapter. Some of these provisions are discussed below.

Remedies Where There Is a Formation Problem

Articles 18-21 in Decree 38 describe some general remedies available to parties when there is a problem in the formation of a contract, as described in previous articles within Decree 38. Article 18 provides that any person "can sue to absolutely rescind" contracts defined in Article 5. Those are contracts that are illegal or inconsistent with public order, good custom, social interests, or social ethics, or whose subject matter is impossible to perform.

Article 19 provides for remedies where a contract is voidable because of incapacity, mistake, duress or fraud. It says that an "aggrieved party" or anyone with a "lawful interest in a claim" can claim to avoid such a contract. It also provides that the claiming party must notify the other party of the claim, and requires that the claiming party sue within 12 months of the notification.

Article 20 provides that the right to sue of parties making claims under Article 19 ceases to exist if such parties agree to perform the contract or agree in writing to withdraw the lawsuit. It is not clear if this means that parties

such as minors really lose their right to claim to avoid contracts if they simply agree at some later time to perform the contract.

Article 21 provides that, where there is avoidance of a contract, "the situation prior to entering the contract shall be restored." This would appear to be a kind of reliance remedy. It might sometimes provide parties in such situations with a greater remedy than that usually available for rescission (restitution) under the rules discussed elsewhere in this Chapter.

Remedies Where There is a Failure to Perform

Article 31 appears to discuss remedies where there is a failure to perform according to a contract. It provides that a "creditor party" shall not be compelled to accept an object other than what she is due under the contract or to accept part performance. However, it also provides that the People's Court can, with regard to "the spirit of goodwill and the financial situation of the debtor party," extend or delay the time for execution of the contract and suspend the creditor's action. Article 31 requires that a court state clearly its reasons for any such decision and exercise this power with great care. This remedy appears to give courts some power to protect financially weaker parties from the enforcement of valid contracts. It seems that courts in many free market jurisdictions do not generally have this power, though they do have other doctrines (such as unconscionability) to protect weaker parties from unfair contracts.

Remedies in Particular Situations

Decree 38 also contains a number of articles that provide for certain remedies in particular situations. A few of these are discussed below.

Decree 38 provides many remedies to parties to sales contracts. For example, Article 38 appears to provide that the buyer can cancel the contract if an item has been lost or substantially damaged prior to delivery and no substitute is provided by the seller, and that the seller must pay damages "relating to the loss of the object or any damages resulting from fault on the part of the vendor." Articles 42-49 contain a number of remedies related to non-conforming tenders and claims related to the true ownership of the property. For example, Article 48 provides that a buyer can ask a court for rescission where the seller obtained the property through a crime. Article 51 provides that parties can stipulate in the contract that the buyer must pay interest if payment is late. It basically says no pre-judgment interest is available unless the contract provides for it, but adds that "where the sale item yields income or profit," the interest "shall be calculated according to the rate set by law." Article 54 provides for rescission by the seller where the buyer fails to pay in full. Article 55 states that a rescission requires the parties to "return to each other what they have received." This would appear to be basically a restitution remedy.

Decree 38 contains a number of other remedies for particular situations. For example, Article 60 provides that, in loan contracts, interest charged in excess of the legal rate shall be returned to the borrower, together with interest on that excessive amount. Article 70 states that a personal property mortgage creditor can ask the court to have mortgaged property sold if a debtor fails to pay, and provides procedures for such sales and for the disposal of the proceeds.

Decree #100D (the Land Law) contains remedies related to the transfer of interests in real estate. For example, Articles 183-187 provide remedies related to the sale of estates. Article 183 appears to allow rescission by the seller where "the estate is sold at lower than half the price at which it should be sold..." It is not completely clear what this means, but it may give a court more power to allow rescission than many free market jurisdictions would in this situation.

Finally, the Labor Law (1997) provides a number of remedies related to labor contracts. For example, Articles 73-95 specify a number of remedies where an employment contract ends. Article 89 describes the compensation an employer must pay to a laborer where the employer terminates the contract and there is no serious offense by the worker. Article 91 appears to say that where one party terminates an employment contract without proper cause, the other party may request compensation.

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to remedies appears to be generally compatible with the one discussed in this Chapter. However, specific performance seems to be more often used in civil law jurisdictions than in common law jurisdictions. And civil law jurisdictions may be somewhat more willing to order contract remedies that may be viewed as punitive than common law jurisdictions are. Of course, the exact rules about remedies vary from one jurisdiction to another, so it is important to check the relevant local law.

It appears that the most important difference between the civil law approach to remedies and the one discussed in this Chapter is that civil law jurisdictions are more likely to order specific performance than common law jurisdictions are. As explained above, courts in many common law jurisdictions order specific performance only if they believe that damages are inadequate and that they can adequately enforce the order of specific performance. However, in civil law jurisdictions, it appears that specific performance is ordered more frequently, and that it is even available for goods that are commonly available. This appears to be the case in Germany. In France, specific performance seems to be available for most contract breaches, except for personal service contracts. In general, French contract law with regard to remedies seems to aim primarily to ensure that the rights of the parties are protected, rather than primarily to compensate the non-breaching party, as is the main goal in many common law jurisdictions.

This somewhat different focus may account for the greater willingness of civil law jurisdictions to order specific performance.

Other remedies available in civil law jurisdictions include withholding of performance and rescission. Many civil law jurisdictions seem to allow some remedies for breach that may be more flexible than those discussed in this Chapter. For example, for sale of goods contracts, German law appears to allow a buyer who receives a non-conforming tender the option of accepting the goods and reducing the price she pays. This apparently is closer to the way many parties actually conduct their business. As the reader will recall, the rules discussed earlier in this Chapter and earlier in this text are that the buyer's duty to pay becomes due if she accepts, though of course she would have the right to bring a claim for damages for the harm caused to her by the seller's breach.

Of course, damages are awarded in civil law jurisdictions. In fact, requests for damages seem to be growing more common in such jurisdictions, especially in commercial disputes. When such jurisdictions do order damages, their goal appears to be similar to the goal in common law jurisdictions: to compensate the non-breaching party for the loss suffered as a result of non-performance. There are also a number of requirements comparable to those discussed earlier in this Chapter, such as that damages be foreseeable and reasonably certain.

However, there are also some different aspects to the damages remedy in civil law jurisdictions such as France. In France, it appears that courts do not distinguish so clearly between expectation and reliance damages, although the *Code civil* does differentiate between actual loss and lost gain. In addition, in order for the non-breaching party to recover damages in France, the party must generally provide notice to the breaching party to perform (*mise en demeure*). This apparently means that the party suffering harm must notify the breaching party that she has failed to perform properly and that the notifying party wants proper performance.

Finally, civil law jurisdictions may be somewhat more willing than common law jurisdictions to use contract remedies that might be considered punitive. French courts may order *astreintes*, which are orders to pay a fixed sum for each day or other period that a breaching party remains in default. In addition, French courts may be more willing to enforce stipulated damages clauses that may appear to penalize parties for non-performance. However, as discussed above, there are limits. French courts now have authority to raise or lower the amounts specified in such clauses if they are clearly excessive or too small with regard to the circumstances of the case. In addition, punitive damages would not appear to be ordered often under French law.

10.10 Questions for Review

CHAPTER 10 – QUESTIONS FOR REVIEW

1. Do courts in free market jurisdictions have the power to impose criminal penalties in contract disputes?
2. What is the goal of expectation damages?
3. When are expectation damages awarded?
4. What method do many jurisdictions use to calculate expectation damages?
5. What are some important limits on expectation damages?
6. What is the goal of reliance damages?
7. When are reliance damages awarded?
8. What is the goal of restitution damages?
9. When are restitution damages awarded?
10. What is a stipulated damages clause?
11. When are stipulated damages clauses enforced?
12. What are nominal damages?
13. When do courts order parties to pay interest in contract disputes?
14. Do courts generally order parties to pay punitive damages in contract disputes? Why or why not?
15. What are three important limits on the damages that parties can recover in contract disputes?
16. With regard to foreseeability, what are the two types of contract damages, and when is each awarded?
17. When do courts order specific performance of a contract?
18. What other non-monetary remedies might courts order?
19. Describe remedies that might be available in contract disputes involving the sale of goods.

20. What remedies might be available where courts find a quasi-contract or apply promissory estoppel?

21. Is the Cambodian law approach to contract remedies generally compatible with the approach discussed in this Chapter?

22. Is the civil law approach to contract remedies generally compatible with the approach discussed in this Chapter?

CHAPTER ELEVEN

THIRD PARTY RIGHTS AND DUTIES

11.1 Introduction

In most situations, only the parties who actually make a contract together have any rights or duties under that contract. This is because those who are not parties to the original contract--who are generally called "third parties"--usually have no legal interest in the contract.

However, in certain situations, third parties may actually have rights or duties under a contract--even though they are not parties to the contract! This can occur where there is an assignment of rights or delegation of duties, or where there is a third party beneficiary. This Chapter discusses these events.

It may seem odd that third parties can gain such rights or duties. Some basic reasons that the law provides for this possibility are to give effect to the real intentions of the parties who made the original contract, and to further important social and economic goals. These reasons will be discussed further in Section 11.2 below.

*** ***ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4j has a concise discussion of third party rights and duties.

11.2 Third Parties May Have Rights or Duties under Contracts in Several Important Situations

This Chapter examines three important situations where third parties may have rights or duties under a contract. These situations are where:

(1) a contract party assigns his rights under a contract to a third party (Section 11.3);

(2) a contract party delegates his duties under a contract to a third party (Section 11.4); and

(3) a third party beneficiary gains rights under a contract (Section 11.5).

Each of these situations is briefly summarized below.

An assignment of rights occurs where a party to a contract transfers his rights under the contract to a third party who is not a party to the original contract. This transfer is not a promise or a contract, but a present-time transfer--like a gift. It is not subject to the common law requirement of consideration, though assignments without consideration are revocable in certain cases in common law jurisdictions. Contract rights can generally be assigned. However, many jurisdictions say contract rights cannot be assigned: if the assignment would materially change the duty of the other party to the original contract, materially increase the risk to that party because of the contract, or substantially reduce the value of the performance that party will receive; if a valid part of the original contract forbids the assignment; or if the assignment violates a statute or public policy. An example of rights which may not be assignable are rights to receive personal services. When a party assigns his rights to a third party, the third party gains those rights like the party would gain property, and the transferring party no longer has the rights. So the third party basically "stands in the shoes" of the transferring party, with the same rights and subject to the same defenses as the transferring party previously was. Assignment of rights is discussed in Section 11.3 below.

A delegation of duties occurs where a party to a contract transfers his duties under the contract to a third party who is not a party to the contract. When a party delegates his duties to a third party, the third party may have the option to perform, or he may promise to perform. The third party becomes responsible for performing those duties only if he has promised to perform them. However, unlike in the situation where a party assigns rights, the delegating party remains responsible for the performance of the duties, even after he has delegated them. Contract duties can be delegated as long as the party with the right to receive performance of the duties will still receive the substantial benefit of his original bargain, and no valid part of the original contract forbids the delegation. Duties are less likely to be effectively delegated if they involve personal services or other types of unique skills or abilities, such as the professional services of physicians. Delegation of duties is explained in Section 11.4.

A third party beneficiary can actually gain rights under a contract, even though that third party was not a party to the contract. Many jurisdictions say this occurs only where the third party was an intended beneficiary. That means that the parties to the original contract intended that the third party gain the right to enforce their contract. But if a third party is merely an incidental or unintended beneficiary, he cannot enforce the contract. Intended beneficiaries may be donee beneficiaries, who exist where the party receiving the promise that will benefit the third party beneficiary is basically trying to make a gift to the beneficiary. Or they may be creditor beneficiaries, who exist where the party receiving the promise that will benefit the third party beneficiary is actually trying to fulfill some existing legal duty that he owes or believes he owes to the beneficiary. Important examples of donee beneficiaries include third party beneficiaries under life insurance policies. Important examples of creditor beneficiaries include loan creditors like banks after

a third party assumes a debtor's duty to repay to such a creditor a loan secured by a mortgage on real property. Third party beneficiaries are discussed in Section 11.5.

A crucial difference between the situation where assignment or delegation occurs, and the situation where a third party beneficiary gains contract rights, is how the rights or duties are created. The rights of third party beneficiaries are created by the original contract. But assignment and delegation occur after the original contract has been created, through some later action of one of the parties to that contract.

It is also important to distinguish between the situation where assignment or delegation occurs, and the situation where a novation occurs. As discussed in Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e, a novation exists where both parties to the original contract agree with a new third party that that third party will substitute for one of the parties to the original contract, and that the original contract will be ended. So a novation frees one of the original parties from any obligation under the contract, and results in a new contract between one of the original parties and the third party. By contrast, an assignment or delegation can generally occur even if only one of the original contract parties wants it to happen. And the original contract duties are not discharged. When a delegation occurs, the delegating party is not released from his duties--he remains liable until the third party to whom the duties are delegated actually performs.

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e contains more detailed discussion of the effects of novations.

*** ***WHY IS THIS IMPORTANT?*** Why does the law say that third parties can actually have rights or duties under a contract in certain situations, even though they were not parties to the contract?

In general, only those who are actually parties to a contract have any legal interest in the contract. So only those parties can generally enforce the contract, or bring legal claims about the rights and duties in the contract. This is an important part of the freedom of contract. It generally allows parties to do as they wish with their contracts, without fear of interference from anyone else. It helps them achieve their economic and social goals, and helps the free market function efficiently.

However, in certain situations, many jurisdictions say that third parties do have rights and duties under contracts they did not make. As noted above, some basic reasons that the law provides for this possibility are to give effect to the real intentions of the parties who made the original contract, and to further important social and economic goals.

First, where there is a valid assignment or delegation, or an intended third party beneficiary, one or both parties to the original contract have indicated that they wish a third party to have rights or duties created by their contract. In a way, respecting their wishes in this way is another way to give them the freedom to conduct their relations as they wish--as the freedom of contract does.

Recognizing third party rights and duties also promotes important economic and social goals. It allows parties the flexibility to conduct business and transfer property in efficient ways. That helps the parties and the economy work better. One example occurs where a party assumes a loan secured by a mortgage on real property (a delegation). Another example is where a party assigns the right to repayment of a long term loan to a party who may have more interest in the loan, or ability to collect the loan from the debtor.

These kinds of transfers also help many parties obtain commercial financing. Such parties may be able to get loans to conduct their businesses, or start new ventures, by offering as collateral their rights to receive payment under other contracts. For example, builders may make this kind of assignment in order to get the funds they need to actually build structures.

In addition, third party rights and duties can serve important social interests. For example, many parties buy life insurance policies. Such parties designate third party beneficiaries--often their family members such as spouses and children--to receive money or other benefits in the event that the policyholder dies. These beneficiaries can gain the right to enforce the insurance contract, even though they were not parties to it. This can be a useful way to protect the future of family members, even if the policyholder cannot do so himself. Parties can provide for these needs in a variety of other contract situations as well.

Of course, great unfairness and economic chaos could result if parties had an unlimited ability to transfer rights and duties to third parties, or if third parties were allowed to interfere in contracts that really had nothing to do with them. That is why the law applies the important limits on third party rights and duties which are noted above, and further explained in the rest of this Chapter.

11.3 An Assignment of Rights Occurs Where a Party to a Contract Transfers His Rights under the Contract to a Third Party

Perhaps the most important way a third party can gain a right or duty discussed in this Chapter is assignment of rights. This Section will explain

some of the more important aspects of assignment of rights. Specifically, it will discuss:

(1) the basic elements of an assignment of rights (Section 11.3a);

(2) what contract rights can be assigned (Section 11.3b); and

(3) some of the legal effects of an assignment (Section 11.3c).

11.3a What Is an Assignment of Rights?

Assignments of contract rights occur frequently in free market jurisdictions, and they are important to the working of modern economies. So this text will examine assignment in some detail.

*** **DEFINITION:** An **assignment of rights** is a present-time transfer of contract rights from one party to a contract to a third party.

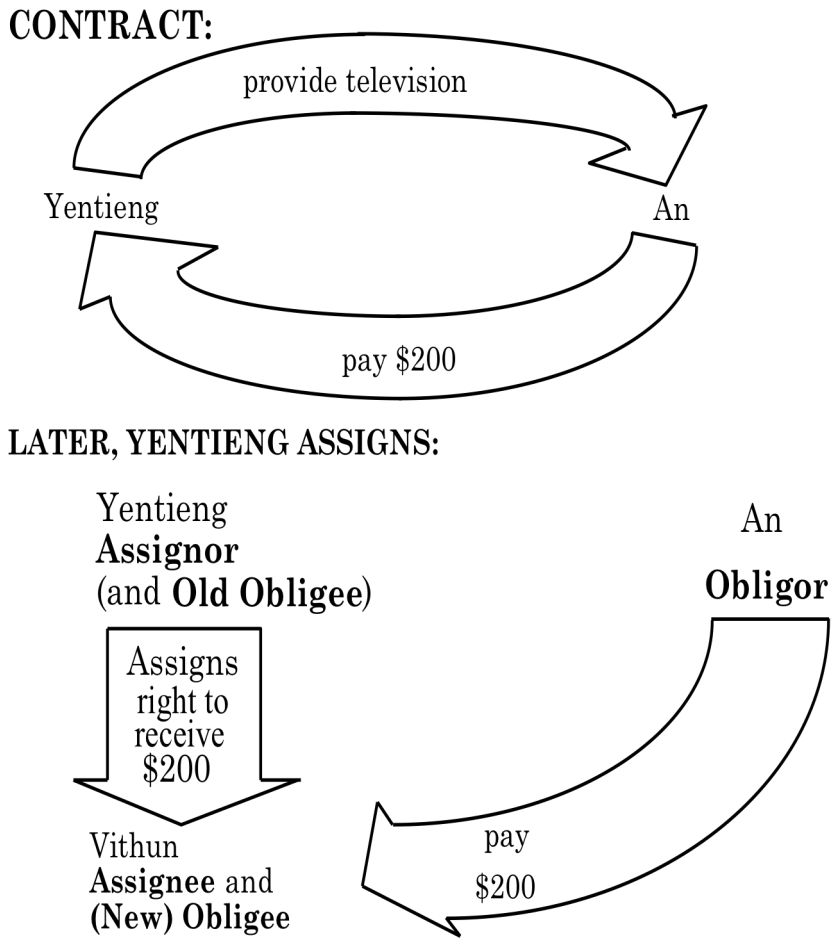
In addition to the fundamental definition above, there are also some related terms that are necessary to a discussion of assignment. First, the party who actually makes the assignment of contract rights is called the assignor. The third party who receives the rights is called the assignee. The assignee is also called the obligee (or "new obligee"). This is because the assignee is also the party to whom one of the original contract parties is now obligated to provide performance. (The assignor might also be called the "old obligee," since he was previously the party to receive performance.) And the original contract party who did not make the assignment is called the obligor, because he is the party who still has the obligation to perform. Only the party who is to receive the benefit of that performance has changed, from the assignor to the assignee.

An assignment is a present-time transfer of contract rights. In this way, assignment is like a gift. It is not a promise or a contract, although it may be part of a contract between the assignor and the assignee. Because an assignment is a present transfer, a promise to transfer contract rights in the future is not an assignment. And while an assignment results in the assignee gaining contract rights, it also results in the assignor losing those rights. After an assignment, the assignor no longer has the rights he has transferred.

For example, suppose An and Yentieng make a contract under which An agrees to buy a television from Yentieng for $200. Yentieng has the duty to provide the television, and An has the right to receive the television. An has the duty to pay $200, and Yentieng has the right to receive that money. Suppose that, after this contract is made, Yentieng assigns his right to receive the $200 to Vithun, perhaps because Yentieng owes Vithun $200 from some prior transaction. In this situation, Yentieng is the assignor (and "old obligee"), because he has assigned his contract rights to Vithun. Vithun is the assignee, because he is the third party who has received the contract rights. Vithun is also the obligee (or "new obligee"), because Vithun--not Yentieng--

is now the party to whom An owes the obligation of paying $200. And An is the obligor, because he still has the obligation to pay $200. The result of this assignment is that Vithun has an enforceable right to receive $200 from An, and that Yentieng no longer has that right. The following chart illustrates how assignment of rights works, using this example.

Illustration: How a Typical Assignment of Rights Works



Of course, in this example, it is not clear what happens to Yentieng's duty to provide the television to An. Yentieng may still have that duty. Or he may delegate the duty to Vithun, in addition to assigning his rights to receive payment to Vithun. This will depend on the particular situation, as will be discussed below.

An important problem with regard to assignment may occur where a party says that he is "assigning the contract" or "assigning all my rights under

the contract." It can be very difficult to decide what is really happening here, and courts may have different approaches.

First, it appears that many jurisdictions would interpret "assigning the contract" to mean that the assignor is transferring the contract rights and the contract duties, unless the circumstances indicate otherwise, or the party receiving the duties has not agreed to the delegation. In the above example, this interpretation would mean that Yentieng assigned his rights and delegated his duties to Vithun, and that Vithun agreed to the delegation. In that situation, Vithun would have the right to receive $200. But he would also have the duty to provide the television required by the contract. In that case, either the assignor Yentieng or the obligor An could actually enforce the contract against Vithun, if Vithun failed to perform. This will be further discussed in Section 11.4, below.

A second possible interpretation of the expression "assign the contract" is that the assignor is merely assigning his rights under the contract, and the duties remain with him. In the above example, that would mean Yentieng transfers to Vithun his right to receive $200 from An. But the duty to provide the television to An would remain with Yentieng. This often occurs.

A third possibility which sometimes occurs where parties "assign the contract" is that a party assigns his contract rights, but it is clear that if the assignee wants to receive the benefit of those rights, the assignee must actually perform the contract duties. The key difference between this possibility and the first possibility is that the assignee here is not obligated to perform the duties. In other words, he has the option to perform them or not. This is a kind of delegation, as will be discussed in Section 11.4, below.

A common way this third possibility might occur is where an assignor "assigns" an executory contract to buy real property to an assignee in exchange for a payment from the assignee that is small compared to the size of the contract. For example, suppose Yentieng assigned to Vithun an executory contract to buy a big new villa for $200,000, making the assignment in exchange for a $500 payment from Vithun. Vithun would probably have the right to receive the villa only if he actually paid the $200,000 purchase price to the villa owner.

*** ***ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts") contains further discussion about how courts interpret contracts.

In order for a valid assignment to occur, a basic requirement in many jurisdictions is that the assignor clearly communicates to the assignee an intention to transfer a contract right to the assignee. This intention may be communicated directly to the assignee, or to someone on his behalf.

It also important to know about other elements that may be required in order for a valid assignment to occur. First, in many common law

jurisdictions, notice to the obligor is not required in order for the assignment to be effective. However, if the assignee fails to give notice, and the obligor continues to provide contract benefits to the assignor, the assignee will not be able to recover from the obligor for what the obligor has provided to the assignor. So it is very important that the assignee provide notice to the obligor about the assignment as soon as possible if the assignee wishes to enforce the assignment against the obligor. Other jurisdictions, including civil law jurisdictions such as France, may require that the obligor be notified in order for the assignment to be effective.

Second, assignments do not generally require consideration in order to be effective in common law jurisdictions. This is because, as noted above, assignments are not contracts, but instead are present transfers. However, if there is no consideration, the assignment may be terminated by certain events. This will be explained in more detail in Section 11.3c, below.

Third, a valid assignment need not be written unless a specific statute requires it. However, statutes in many jurisdictions do require that assignments be written in particular situations. Important situations where many jurisdictions generally require a writing include where a party assigns a contract right:

(1) to an interest in real estate;

(2) to the payment of money arising from contracts for services or the sale or lease of goods;

(3) to a security interest in personal property or fixtures;

or (4) as part of a contract that the law requires to be written.

A "security interest" basically occurs where one party receives an interest in property to secure another party's duty to repay money or do something else for the first party. Perhaps the most common example of this occurs where a party mortgages property to secure a loan to pay for that property. This generally means that the creditor can only exercise his right to take and sell the property if the loan is not repaid according to the loan contract. The exact circumstances where these kinds of assignments may occur can be very complex, and the legal requirements vary in different jurisdictions.

******* ***CASE STUDY 246***

FACTS The Royal Construction Company makes contracts to build 10 new buildings in various places in Battambang, for payments totaling $1,000,000. Royal Construction is very excited about these opportunities, and it wants to begin work right away. However, it does not have enough cash to get all the equipment, materials, and services it needs to pursue the projects. And the construction contracts do not provide for substantial payments to Royal to occur for several months.

In order to get the money it needs to perform the construction, Royal makes a loan contract with the New Nation Bank. This written contract provides that the Bank will lend Royal $900,000 in one payment to be made immediately, and that in exchange Royal assigns to the Bank its rights to all the payments under the construction contracts it has recently made. The duties to build remain with Royal. The Bank provides the $900,000 to Royal and promptly notifies the property owners about the assignments. Royal starts work.

The time comes for some property owners to pay money under the construction contracts Royal made. The owners make their payments to the New Nation Bank. But Royal objects. Royal says that the Bank is not a party to those construction contracts, and that only Royal has the right to receive those payments.

QUESTION OF LAW Does the New Nation Bank have the right to receive the payments originally due to Royal under the construction contracts, even though New Nation is not a party to those contracts?

DECISION Yes. The New Nation Bank does have the rights to receive these payments, because Royal Construction made a valid assignment of those rights to the Bank.

An assignment of contract rights occurs where one party to a contract clearly indicates an intention to transfer his contract rights to a third party. In this case, Royal Construction made a loan contract with the New Nation Bank in which Royal expressed a clear intention to assign its rights to receive $1,000,000 in payments under various construction contracts to the Bank, in exchange for an immediate loan of $900,000 by the Bank. As soon as the Bank got the assignment of these rights, it had the right to receive these payments--and Royal no longer had that right. This is true even though it was Royal who still had the duty to build the buildings. And it is true even though the Bank was not a party to the original construction contracts Royal made with the property owners. In addition, since the assignment was written, it would meet the writing requirements many jurisdictions have for assignments of the right to receive money under contracts for services.

11.3b Contract Rights Can Generally Be Assigned

Most contract rights are assignable. As discussed above in Section 11.2, assignment of rights is an important part of the economies of many free market jurisdictions. So these jurisdictions want to promote the use of assignment, and avoid unnecessary restrictions on that right. In fact, this might be called the "freedom of assignment!"

However, there are a number of situations where rights cannot be assigned. These limits exist because assignment in some situations would be unfair to obligors, or harm other important economic or social interests.

In these cases, the law is trying to balance the importance of assignments with other important policies.

Five situations where the law in many jurisdictions limits the ability of parties to assign contract rights are where the assignment:

(1) would materially change the obligor's duty;

(2) would materially change the risk to the obligor because of the contract;

(3) would substantially reduce the value of what the obligor would receive under the contract;

(4) is prohibited by a valid provision in a contract;

or (5) is prohibited by statute or public policy.

Each of these five situations is examined below.

(1) An Assignment Is Not Valid If It Would Materially Change the Obligor's Duty

An assignment is not valid if it would materially change the obligor's duty. One situation in which this might occur would be in a personal services contract. In some cases, the assignment of the right to receive personal services could make a fundamental change in what the obligor would be required to do under the contract. Consider the following Case Study.

*** ***CASE STUDY 247***

FACTS Peng makes a contract to teach Chinese to Rithya for three months. However, soon after the contract is made, Rithya gets busier at work, and he no longer has time to take the lessons. So he tries to assign his rights to receive the lessons to his friend Kieth.

Peng objects, saying Kieth is a very different student, because Kieth is far less advanced and more difficult to teach, and because Kieth wants to learn in a dangerous part of the city. Peng says this kind of assignment is not fair to him.

QUESTION OF LAW Can Rithya assign his rights to receive Chinese lessons to Kieth in this way?

DECISION Probably not. Rithya probably cannot assign his rights to receive the lessons to Kieth, because it would probably result in a material change in Peng's duties under the contract.

Contract rights cannot be assigned where the assignment would result in a material change in the duties of the obligor. In this case, Rithya tried to assign to Kieth Rithya's rights to receive Chinese lessons from Peng.

Rithya may be unable to assign his rights to Kieth under this personal services contract. This is because the assignment might cause a material change in the duties of Peng, the obligor. Teaching Rithya appears to require a different range of skills and activities by Peng. Peng says Kieth is a far less advanced student, and more difficult to teach, and that Kieth wants to learn in a more dangerous location than Rithya. This assignment would seem to result in a material change to Peng's duties under the contract. So it would probably not be effective.

Another area in which changes in the obligor's duty might occur would be in output and requirements contracts. These contracts were already discussed in some detail in Chapter 3 ("Consideration"), Section 3.5d. For example, a buyer in a requirements contract might be unable to assign his rights to receive goods under the contract to a different party. The reason is that that different party might have very different requirements from the assignor. This would obviously change the duties of the seller--the obligor. Some jurisdictions, such as those that apply the Uniform Commercial Code in the United States, say that parties generally can assign their rights under output or requirements contracts if the assignee's output or requirements are not clearly disproportionate to the output or requirements of the assignor. Of course, this appears similar to the "material change" rule discussed above.

*** ***ADDITIONAL REFERENCE:*** Chapter 3 ("Consideration"), Section 3.5d contains more detailed discussion of output and requirements contracts.

(2) An Assignment Is Not Valid If It Would Materially Change the Risk to the Obligor

An assignment is not valid if it would materially change the risk to the obligor because of the contract. This might happen because the assignment would change a risk that an obligor is assuming under the terms of the contract. Or it might occur because the assignment would increase the risk that the obligor would not receive the performance due to him under the original contract.

An example of a material change in the risk an obligor assumes under the contract would be the risk of an insurance company in an insurance contract. For instance, suppose a car owner has an insurance policy on her car. She sells the car, and tries to assign her rights under the insurance policy to the buyer. This assignment is probably not valid. That is because the risk of the insurance company (the obligor) under the insurance contract was probably based to a large extent on the driving record and habits of the policyholder (assignor). But the car buyer (assignee) in this situation may have a completely different driving record and different habits. So an assignment like this could materially change the risk of the obligor.

Situations where an assignment of rights would materially increase the risk that the obligor will not receive performance under the contract

would be less common. This is because merely transferring the assignor's rights would not usually affect the obligor's chances of receiving performance of the assignor's duties. However, this kind of change could still occur where the transfer of the rights would actually affect the assignor's ability to provide performance to the obligor.

For example, suppose a sale of goods contract provided that the seller would receive pre-payment from the buyer, in order to help the seller get the goods from another source. An assignment by that seller of his rights to payment could actually affect the seller's ability to provide the goods. This is because, without the pre-payment, the seller might be unable to obtain the goods. So that kind of assignment could materially affect the buyer's (obligor's) chances of receiving performance.

(3) An Assignment Is Not Valid If It Would Substantially Reduce the Value of What the Obligor Would Receive

An assignment is not valid if it would substantially reduce the value of what the obligor would receive under the contract. This situation would not seem to occur often.

One case where it might happen would be where an assignor tries to transfer his rights under an output or requirements contract. As noted above, this kind of assignment could change the obligor's duties. But it could also reduce the value of what the obligor would receive. This might occur if the assignee of a buyer's rights in a requirements contract actually needed far less of the goods involved in the contract than the original parties expected, or if the assignee of a seller's rights in an output contract produced far less. In those cases, the obligor might receive far less than he expected under the original contract. So such an assignment might not be valid.

(4) An Assignment Is Not Valid If It Is Prohibited by a Valid Provision of the Contract

Many jurisdictions will give some effect to contract provisions which forbid assignment. For example, a contract may say that "rights under this contract shall not be assigned." These provisions are sometimes called "anti-assignment clauses." Courts generally enforce such provisions. They often appear in contracts, because most obligors would rather not have to deal with assignees! Obligors generally prefer to deal only with those with whom they actually make contracts. And where obligors make that preference clear in their contracts, the law in many cases respects their preference.

However, many jurisdictions limit the ability of parties to prohibit assignment, and limit the effects of those assignments even where they are permitted. The basic reason for these limits--which actually limit the freedom of contract--is that these jurisdictions believe that assignments are important for the financing of business activity, and for other economic and

social reasons, as discussed in Section 11.2, above. So in this situation, the law balances competing goals--the freedom of contract and the freedom of assignment.

One important type of limit in this area is that statutes in many jurisdictions simply say that anti-assignment clauses are ineffective with regard to many important kinds of assignments. For example, the Uniform Commercial Code in the United States basically makes ineffective any restriction on the assignment of rights to receive payment for services or goods sold or leased, or to a security interest in personal property or fixtures.

Many other limits relate to how courts interpret anti-assignment clauses. Several of these limits are discussed below.

Sometimes a contract provision basically says that the "contract shall not be assigned." Many jurisdictions actually interpret that to mean that the parties cannot delegate duties under the contract, but that they can still assign rights, subject to the other limits discussed in this Section.

Of course, if a contract provision basically says that the "rights shall not be assigned," then courts in many jurisdictions do interpret that as a promise not to assign rights. Courts will enforce that promise, and provide a remedy to a party harmed by a failure to follow that promise. However, many jurisdictions say that an assignment that violates a promise like that is still effective! It is only that the assignor is liable to the obligor for breach of the contract promise not to assign.

Sometimes a contract provision basically says that contract rights "shall not be assigned without the consent" of the other party. Many courts interpret that kind of provision to mean that a party cannot unreasonably withhold his consent.

Finally, where a contract basically says that "any attempted assignment is void," many jurisdictions interpret that to mean that any assignment is not effective against the obligor--but that it is still effective between the assignor and the assignee! So while the obligor is not required to deal with the assignee, the assignor is still responsible to the assignee for any legal damage caused by the improper assignment. Such damage will be further discussed in Section 11.3c.

Obviously, courts in many jurisdictions work hard to promote the use of assignments! Parties who want to limit that use must draft their contracts carefully. And even then, they may be unable to limit the use of assignments the way they wish.

*** ***CASE STUDY 248***

FACTS The Elated Restaurant has a contract with the Friendly Fish Supply Company under which Friendly will supply a certain quantity of fish every month, for a certain price, for one year. The contract says that the "contract shall not be assigned."

However, after a few months, Friendly is short of cash it needs to pay some creditors. Friendly attempts to assign its rights to receive payment for the fish under its Elated contract. The attempted assignee is Triv, the owner of one of the fishing boats that supply Friendly.

Elated objects to this assignment, saying it does not like Triv, and that the supply contract forbids assignment. Friendly says that the contract clause is ineffective.

QUESTION OF LAW Does the anti-assignment clause in the fish supply contract between Elated and Friendly prevent this assignment?

DECISION Probably not. In many jurisdictions, the assignment clause in this contract would be ineffective under a statute, and even if it was not, it would probably be interpreted to permit the kind of assignment that Friendly tried here.

Anti-assignment clauses in contracts are often enforceable, but many jurisdictions impose limits on them. Some jurisdictions say such clauses are ineffective with regard to assignments of rights to receive payment for goods or services. Many jurisdictions also interpret such clauses in a way that promotes assignments, such as by saying that phrases forbidding parties to "assign the contract" really only forbid delegation of duties.

In this case, the Friendly Fish Company tried to assign its right to payment under a fish supply contract with the Elated Restaurant to Triv. Elated objected, noting the contract clause saying the contract could "not be assigned." However, many jurisdictions would say that this anti-assignment clause was not effective to prohibit this assignment, and so the assignment was effective. Many jurisdictions completely prohibit anti-assignment clauses that try to prevent assignments of rights to payment for goods or services--the kind of assignment Friendly attempted here. And many jurisdictions also say that clauses forbidding parties to assign "the contract" only mean that the parties cannot delegate the contract duties--not that they cannot assign the contract rights, as Friendly did here. So this anti-assignment clause is unlikely to be enforced. Friendly's assignment to Triv is probably effective.

(5) An Assignment Is Not Valid If It Is Prohibited by Law

Finally, the law in many jurisdictions simply says that certain contract rights cannot be assigned, regardless of what the contract may say.

For example, many jurisdictions ban or limit parties' ability to assign their rights to receive wages or salary for personal services. And many jurisdictions also limit parties' ability to assign rights related to government pensions, and alimony and child support agreements. Basic reasons for these limits would seem to be to protect assignors from being pressured into assigning important rights that serve to protect them, and to protect obligors like the government from being forced to deal with new assignees.

Another traditional general limit many jurisdictions have applied is that parties cannot assign rights under contracts that do not exist yet--contracts that parties expect to be formed in the future. It does not matter whether the right being assigned has actually been "earned" at the time it is assigned--whether the assignor has actually performed his duties under the original contract--as long as that contract actually exists at the time of the assignment. Of course, a party can promise to assign a right that he expects to exist in the future. But the traditional rule is that there must be an existing contract right at the time of assignment, or else there is really no "right" to assign, and no valid assignment.

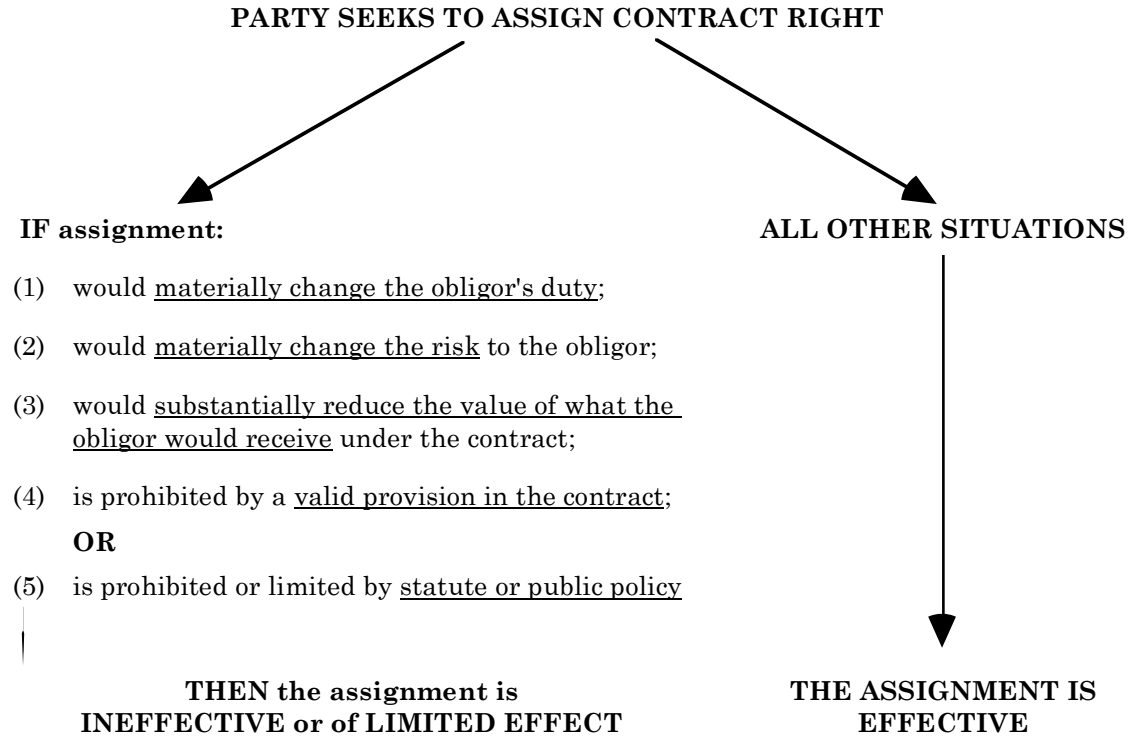
Some jurisdictions have changed this traditional general rule to some extent. These jurisdictions say that a party can actually make a valid present transfer--an assignment--of a right that is not part of an existing contract in the special situation where the right is expected to arise out of an existing business or employment relationship. In addition, statutes in some jurisdictions say that for assignments in certain situations--such as those of rights to receive payments for goods or services, or for security--the assignor can basically agree with the assignee that rights under future contracts will be assigned the instant those contracts do exist, without the need for any further action by the parties.

(6) Summary of Some Basic Ideas about Which Contract Rights Can Be Assigned

The following chart shows some of the basic ideas that many jurisdictions have about which contract rights may be assigned.



Illustration: Which Contract Rights May Be Assigned



11.3c The Effects of an Assignment

As noted above, the general effect of an assignment is that the assignor makes a present-time transfer to the assignee of rights under a contract. This means that, after the transfer, the assignee possesses those rights, and the assignor no longer does.

In effect, the assignee "stands in the shoes" of the assignor. This means that the assignee generally:

(1) has the same rights that the assignor had, including the right to make any claims the assignor could have made about the contract;

and (2) is subject to the same defenses that the obligor could have made against the assignor about the contract.

The first part of this general rule means that the assignee has the right to enforce the contract in the same way that the assignor could have enforced it before the assignment. For instance, in the television sale example above, where Yentieng assigned to Vithun his right to receive $200 from An, suppose An paid Vithun only $100. Vithun would have the right to enforce the contract, and ask a court for a remedy for damage he suffered because An failed to pay the remaining $100.

The second part of this general rule means that the obligor generally has the same defenses that he would have had against the assignor before the assignment. These include defenses regarding problems with the formation of the original contract, and defenses about the performance of the contract. For example, if the television sale contract was actually the result of a unilateral mistake by An, or if An never received the television as required by the contract, An could raise those issues as defenses against a claim by Vithun for the $200.

One important defense an obligor might make is simply that he has already paid or provided what he was obligated to pay or provide under the contract. This can occur where the assignee claims the obligor never paid him, and the obligor claims that he already paid the assignor. Many jurisdictions say that prior payment is a valid defense until the assignee has given notice to the obligor about the assignment. But after the assignee has notified the obligor about the assignment, the obligor can no longer successfully defend against the assignee's claim for payment by saying he already paid the assignor. So it is essential that an assignee notify the obligor about the assignment as soon as possible if he wishes to enforce the rights he has received against the obligor. This rule was already noted in Section 11.3a.

For instance, in the television example above, suppose Vithun notified An about the assignment, but An forgot about the assignment, and later paid the $200 to Yentieng. Then Vithun brought a claim against An for the $200. Many jurisdictions would say that An could not defend the claim on the basis that he already paid the $200 to Yentieng. That is because An had notice about the assignment before he paid the $200, and he should not have paid Yentieng. In that situation, An might actually have to pay another $200! But suppose Vithun failed to notify An about the assignment, and An paid the $200 to Yentieng as the original contract required. If Vithun then brought a claim against An for the money, An would have a good defense on the basis that he already paid Yentieng.

Another important issue is whether the assignee can recover against the assignor where the assignee has difficulty getting the benefits of the rights that have been assigned to him. In many common law jurisdictions, if the assignment was gratuitous--not for consideration--then the assignee can probably recover from the assignor only if the assignee reasonably relied to his detriment on the assignment. Of course, this idea is similar to promissory estoppel, as discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

But if the assignment was in exchange for something of value--if there was consideration--then many common law jurisdictions say the assignor is actually making some implied promises along with the assignment.

The assignee can bring a claim against the assignor for breach of those promises, which are that:

(1) the assignor will do nothing to interfere with the assignee's enforcement of the rights against the obligor;

(2) the assigned rights are valid and not subject to undisclosed defenses;

and (3) any documents evidencing the transferred rights are genuine.

However, the assignor does not make implied promises that the obligor is willing or able to perform.

For instance, in the television example above, suppose Yentieng assigned to Vithun his rights to receive $200 from An, in exchange for some consideration. Yentieng would be making implied promises that he actually has the right to receive the $200, and that he will not try to transfer the same rights to someone else, which could interfere with Vithun's ability to enforce the assignment. But he would not be making an implied promise that An was willing or able to pay the $200.

In some cases assignments may be terminated, even though they are present-time transfers. However, many common law jurisdictions say that an assignment cannot be terminated if:

(1) the assignor makes it in exchange for consideration;

(2) the assignor delivers to the assignee a document that symbolizes the rights being transferred (such as an insurance policy or stock certificate);

(3) the assignor delivers a written assignment to the assignee;

(4) the assignee justifiably relies to his detriment on the assignment;

OR (5) the obligor actually provides the performance owed to the assignee, the assignee gets a court judgment against the obligor with regard to the assigned right, or the assignee and obligor modify the assigned right with a new contract.

These rules basically mean that assignments for consideration cannot be terminated. Gratuitous assignments can be terminated except where one of the other situations listed above exists.



In many jurisdictions, where an assignment can still be terminated, it terminates when:

(1) the assignor revokes it through notice to the assignee or obligor;

(2) the assignor dies or loses capacity;

(3) bankruptcy proceedings with regard to the assignor begin;

(4) the obligor demands or accepts performance from the assignor;

OR (5) the assignor assigns the same rights to someone else.

*** ***CASE STUDY 249***

FACTS Sem makes a contract to buy 100 tons of gravel from Yuthy. Yuthy assigns his right to receive the payment for the gravel to his mother Veyrith, delivering a written document to her that assigns the right. Veyrith thanks her son, but she promises nothing in return for his assignment.

When Sem finds out about this assignment, he is unhappy, because he does not like Veyrith. Sem immediately demands performance from Yuthy, saying that Yuthy's assignment was gratuitous and that he is terminating it. Yuthy says the assignment can no longer be terminated.

QUESTION OF LAW Can Yuthy's assignment to his mother be terminated?

DECISION No. Yuthy's assignment to his mother Veyrith could no longer be terminated because, although the assignment was gratuitous, it was made in a writing delivered to Veyrith.

Gratuitous assignments can often be terminated. However, they cannot be terminated in certain situations. One of these situations is where the assignor delivers a written assignment to the assignee.

In this case, Yuthy assigned to his mother Veyrith his rights to receive payment under the gravel sale contract he had with Sem. Sem tried to terminate this assignment by demanding performance from the assignor Yuthy. That would normally have the effect of terminating an assignment that could still be terminated. But this assignment could no longer be terminated, because Yuthy gave his mother a written assignment. So Sem will have to pay the money to Veyrith.

Sometimes parties assign some but not all of their rights under a contract. Courts allow this kind of partial assignment. However, one potential problem with this is that the obligor might have to defend more than one lawsuit about the same contract. To protect the obligor from that possibility, many jurisdictions say the obligor can force the assignee to join the assignor in--force him to be part of--any lawsuit to enforce the assigned rights.

In other cases, assignors try to assign the same rights to more than one assignee, perhaps because they are short of money. This kind of "multiple assignment" can be a big problem. Of course, if the first assignment can be terminated, the assignment to a new assignee will terminate the first assignment, as noted above. In that case, the second assignee will have the assigned rights.

If the first assignment cannot be terminated, and the assignor later assigns the same rights to another assignee, the later assignment violates any implied promises made as described above. The assignor is liable for harm caused by that kind of breach.

But another problem is which of the assignments is valid--which of the assignees will have the right to receive performance from the obligor. Jurisdictions have different and often complex rules about this, and this text cannot fully explain them. Briefly, many jurisdictions say that the first assignee to receive an assignment that cannot be terminated has the rights, unless:

(1) the other assignee gave consideration for the rights, in good faith, and without knowing or having reason to know of the first assignment;

AND (2) (a) the other assignee received the performance covered by the assigned rights, a court judgment against the obligor, or a document symbolizing the transferred rights; OR

(b) the other assignee made a new contract with the obligor.

The Uniform Commercial Code in the United States basically says that, for assignments of a security interest in personal property or fixtures, the first assignee to file a financing statement with the proper public authority has the assigned rights. A basic purpose of filing these financing statements is to give notice to other potential assignees and creditors about the assignment. Other jurisdictions appear to say that the first assignee to give notice to the obligor has the assigned rights.

Many contracts say not only that assignment is permitted, but also that the obligor waives defenses that obligor might have against the assignee. This kind of "waiver of defense" clause is often used in sale or lease contracts. It allows the seller or lessor to assign strong rights to collect payment to someone else if he chooses to do so--strong because they are not subject to the usual defenses! These "waiver of defense" clauses can be very powerful. They could actually result in an obligor having to pay for goods or services that are defective, or never provided at all! For example, in Case Study 249, a waiver of defense clause might mean that the obligor Sem could not assert any defenses against the assignee Veyrith, even if the assignor Yuthy failed to provide the gravel as the contract required.

Many jurisdictions will enforce these "waiver of defense" clauses, but there are often limits on the ability of parties to use them. Consumer protection statutes limit their use, and doctrines like unconscionability and adhesion may also do so. Unconscionability and adhesion were discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.7.

Another issue related to the assignee's rights is whether the assignor and obligor can modify the original contract in a way that changes the assigned rights. Many jurisdictions permit these changes only in certain situations. For example, jurisdictions that apply the Uniform Commercial Code in the United States allow such changes before the obligor receives notice of the assignment, and after the obligor receives such notice if the assignor has not yet fully performed--but in both cases only if the changes are made in good faith and in accord with reasonable commercial standards.

*** ***ADDITIONAL REFERENCE:*** Chapter 7 ("Other Contract Formation Problems"), Section 7.7 discusses unconscionability and adhesion contracts, and Section 7.8 discusses promissory estoppel; and Chapter 10 ("Remedies") discusses remedies parties may have where there is some problem in the formation or performance of a contract.

11.4 A Delegation of Duties Occurs Where a Party to a Contract Transfers His Duties under the Contract to a Third Party

The other important type of transfer of contract elements to third parties is delegation of duties. This Section will explain the basic elements and effects of such a delegation, and what contract duties can be delegated. Specifically, it will discuss:

(1) the basic elements of a delegation of duties (Section 11.4a); and

(2) what contract rights can be delegated (Section 11.4b).

11.4a What Is a Delegation of Duties?

Delegation of duties is probably less common than assignment of rights. But it is still important to the operation of free market economies.

*** **DEFINITION:** A **delegation of duties** is a transfer of contract duties from one party to a contract to a third party.

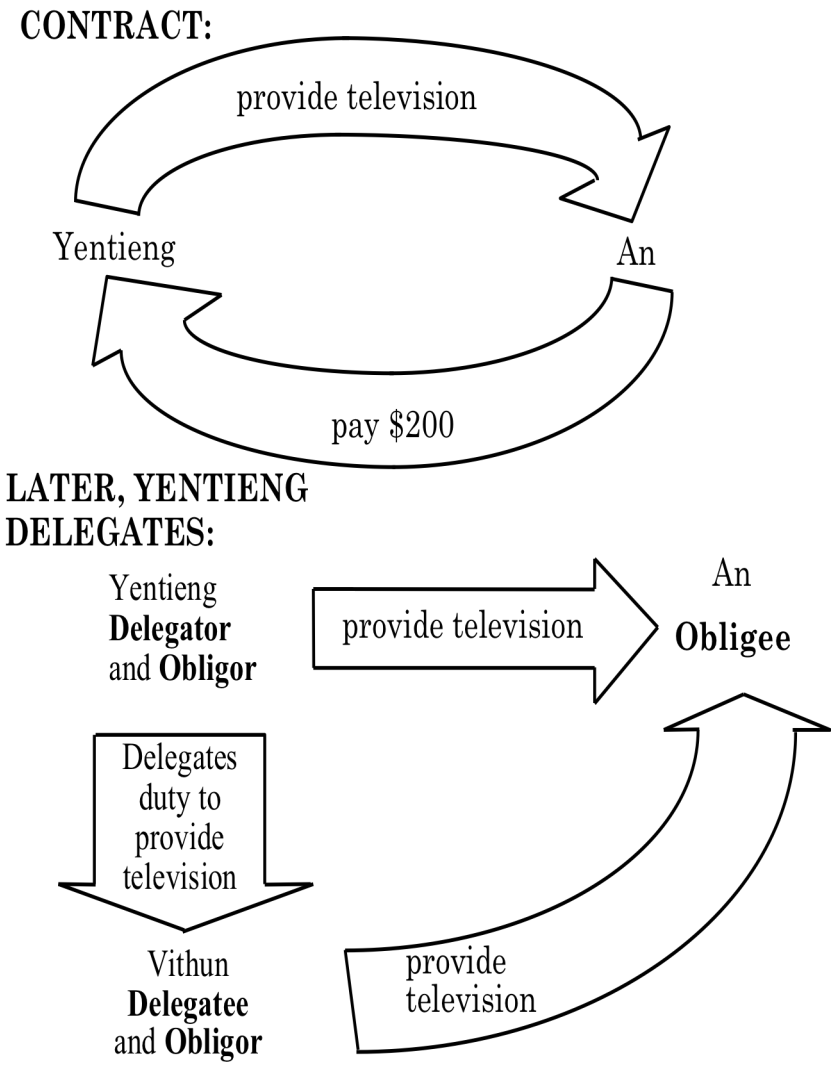
In addition to the fundamental definition above, there are also some related terms that are necessary to a discussion of delegation. First, the party who actually makes the delegation of contract rights is called the delegator. The delegator remains an obligor, since the delegator remains responsible for the duties even after he has delegated them. The third party who receives the duties is called the delegatee. The delegatee may also be an obligor, because he may now also have the duty to perform under the original contract.

And the original contract party who did not make the delegation is called the obligee, because he is the party to whom the delegator and possibly the delegatee owe the duty to perform.

For instance, recall the example from Section 11.3 above, in which An agreed to buy a television from Yentieng for $200. Suppose that, after this contract is made, Yentieng delegates to Vithun his duty to provide the television. Vithun promises to supply the television, perhaps because Vithun owes Yentieng money from some prior transaction. In this situation, Yentieng is the delegator, because he has delegated his contract duties to Vithun. Yentieng remains an obligor, since delegators remain liable for the duties they delegate. Vithun is the delegatee, because he is the third party who has received the contract duties. Vithun is also an obligor, because Vithun has actually promised to perform. He now has the duty to provide the television. And An is still the obligee, because he still has the right to receive the television. The result of this delegation is that An has an enforceable right to receive the television from Vithun--and the right to receive the television from Yentieng, if Vithun fails to provide it. The following chart illustrates how a typical delegation of duties works, using this example.



Illustration: How a Typical Delegation of Duties Works



Perhaps the most important aspect of delegations is that the delegator remains liable for performance of the duty--even though he has transferred it to the delegatee. In most cases, the delegatee performs the duty, and the delegator need not get involved any further. However, if the delegatee fails to perform the duty according to the original contract, the obligee can require the delegator to perform, or seek a remedy for breach of contract. In the above example, that means that if Vithun fails to supply the television according to the contract, An may seek a remedy from Yentieng.

One basic reason that the delegator remains liable is that, without this rule, delegators might not have a strong motivation to delegate to responsible delegatees. Obligees could be harmed in that way. In addition,

without this rule, parties could escape a variety of obligations by simply delegating them to a party who could not perform them, and who could not be held fully responsible, such as a bankrupt person.

In a way, the responsibility of the delegator is like that of a surety. This is because the delegator is responsible to provide performance to a creditor (the obligee) in the event that a debtor (the delegatee) fails to perform.

*** ***ADDITIONAL REFERENCE:*** Chapter 6 ("Formality"), Section 6.3d contains further discussion of suretyship contracts.

Of course, there is a way for the delegator to end his obligations under the contract: a novation. As the reader will recall from Section 11.2 and from Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e, a novation occurs where the parties to an existing contract agree with a third party that the third party will actually take the place of one of the parties to the existing contract. The effect of a novation is that the duties of the party being replaced in the contract are discharged. Of course, a novation requires the consent (express or implied) of the obligee; a delegation does not.

*** ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e contains further discussion of novations.

The basic requirements for an effective delegation are that:

(1) the delegator clearly indicates an intent to transfer a contract duty to the delegatee;

AND (2) the duty is effectively delegated, which occurs if the obligee will still receive the substantial benefit of his bargain and no valid contract provision forbids the delegation.

The second requirement will be discussed in detail in Section 11.4b, below.

As for the first requirement, the delegator can indicate an intent to transfer a contract duty in two ways:

(1) the delegator delegates to the delegatee the option to perform the duty, but the delegatee does not promise to do so;

or (2) the delegator delegates the duty, and the delegatee promises to perform it.

In the first situation above, the delegatee has the option to perform or not. If he does not, then of course the delegator must perform, or be liable to the obligee. In the second situation above, where the delegatee promises to perform, it appears that the delegation requires a contract between the delegator and the delegatee. That contract is subject to all the usual requirements of contracts. The reason for this is fairness to the delegatee.

It would generally not be fair to expect a party to perform contract duties if he never agreed to do so! This is a basic principle of free market contract law.

As with assignments, it is also important to know what is generally not required for an effective delegation. In general, the parties need not notify the obligee, and the obligee need not consent to the delegation. In addition, the usual contract requirements do not apply unless the delegatee actually promises to perform the duties, as noted above.

The main effect of a delegation is that the delegatee has the option or duty to perform. But in either case, the delegator is still responsible for the performance of the duty.

Where the delegatee has promised to perform, the delegatee is liable for failing to perform the contract duties he has assumed. The reason is that he has basically made a contract with the delegator to perform them. The delegator can enforce this contract against the delegatee. And it appears that the obligee can also enforce the contract between the delegator and the delegatee. This is because he will generally be a third party beneficiary of that contract. This is very common, and would appear to be the case unless the circumstances show that the delegatee actually meant his promise to benefit only the delegator, and not the obligee. In any case, when a delegatee promises to perform the delegated duty and will therefore be liable to the obligee, many jurisdictions say that the delegatee "assumes" the duty. Third party beneficiary contracts will be discussed in more detail in Section 11.5, below.

*** ***CASE STUDY 250***

FACTS Pheap makes a contract to buy Chhean's house and land. At the time of the sale, Chhean still owes $20,000 to the Pailin Bank under a mortgage which Chhean took several years earlier in order to borrow enough money to buy the property. As part of the contract between Chhean and Pheap, Pheap agrees to "assume" Chhean's duties to pay this $20,000 according to the loan contract with the Bank.

A few months later, Pheap grows short of money. He stops making payments to the Bank. When the Bank president Sary asks Pheap what the problem is, Pheap says he never made a contract with the Bank, so he has no obligation to pay the Bank. After negotiation fails, the Bank asks the court for help.

QUESTION OF LAW Can the Bank enforce Pheap's promise to pay the rest of the money Chhean owed to the Bank under his original loan contract?

DECISION Yes. The Bank can enforce Pheap's promise, because Pheap's promise in the property sale contract was a delegation to Pheap of Chhean's duty to repay money under Chhean's loan agreement with the Bank.

When one party agrees to "assume" a contract obligation of another party, that is a delegation of duties to the party who assumes the obligation. It means that the delegatee is liable to the obligee for the performance of that obligation.

In this case, Pheap agreed, in his property sale contract, to assume Chhean's obligation to repay the remainder of Chhean's debt to the Pailin Bank under a loan agreement. This means that Chhean delegated to Pheap Chhean's duty to make these payments. Pheap will be liable for a failure to make those payments to the Pailin Bank, the obligee, and also liable to Chhean, the delegator. The Bank is a third party beneficiary of the property sale contract. Of course, Chhean also remains liable to the Bank, since delegators remain liable to obligees for the performance of delegated duties. So if the Bank cannot get the amount due from Pheap, it can still seek it from Chhean.

11.4b Duties Can Be Delegated If the Obligee Will Still Receive the Substantial Benefit of His Bargain

Many jurisdictions say that duties can generally be delegated if the obligee will still receive the substantial benefit of his bargain. This is true even if the obligee objects to the delegation.

To determine whether the obligee will receive the substantial benefit of his bargain, many courts basically ask two key questions:

(1) can this duty be delegated at all?

and (2) if so, can it be delegated to the delegatee in this particular situation?

If the answer to both questions is "yes," then the delegation is effective. Whether a duty is delegable at all depends on whether the obligee has a substantial interest in receiving performance only from the delegator, and not from someone else. Assuming the duty is delegable, courts then ask whether the particular delegation in a case will allow the obligee to receive the substantial benefit of his bargain. In practice, it seems that a delegatee who is especially qualified may be able to receive duties that would not usually be delegable. So the answers to the two questions above may be related. The basic reason for these limits is to protect obligees from delegations which would harm them. That would in turn harm the freedom of contract and valuable economic activity.

The "substantial benefit" rule means that certain kinds of duties are more likely to be effectively delegated than others. In some cases, it is less likely that the obligee will have a substantial interest in getting performance

only from the delegator. In particular, the following kinds of duties are likely to be delegable:

(1) duties to pay money;

(2) duties to provide commonly available goods; and

(3) duties to provide relatively simple or straightforward services, including construction and repair services.

The kinds of services that are probably delegable include relatively "impersonal" or "objective" activities such as building or painting a simple building, transporting some cargo, or digging a well.

However, most duties which involve truly personal services, especially those involving special or unique skills, are unlikely to be effectively delegated. Important examples of these kinds of more "unique" or "subjective" duties include:

(1) duties to teach;

(2) duties to provide aesthetic performances, such as singing;

(3) duties to provide unique manufacturing, construction or repair services; and

(4) duties to provide professional services, such as those of physicians or attorneys.

This distinction between activities that can be more easily measured "objectively" and those that cannot is comparable to some extent to the distinctions many jurisdictions make in analyzing conditions of approval. These were discussed in detail in Chapter 9 ("Performance and Discharge of Duties"), Section 9.4l.

******* ***ADDITIONAL REFERENCE:*** Chapter 9 ("Performance and Discharge of Duties"), Section 9.4l discusses conditions of approval.

Of course, whether a duty is effectively delegated often depends on the particular situation involved. A relatively straightforward contract duty may not be effectively delegated if the proposed delegatee is simply not competent to perform it, or if the facts show that the obligee really wanted only the delegator to perform it. For example, a company might normally be able to delegate the duty to supply wood to another company. But if the facts show that the buyer was relying on the skills of the employees or agents of the delegator, the delegation might not be effective. On the other hand, a duty involving more special skills might be delegable if the facts show that the delegatee actually has those special skills, just as the delegator did. For example, a party might be able to delegate duties that call for the building of a large new port--which would probably require special skills--to a highly qualified builder with a great deal of relevant experience.

So as already noted, the answers to the two key questions discussed above may be related.

In general, it seems that parties have far more power to control through contract provisions whether their duties will be delegated than they do whether rights can be assigned. Parties can agree in the contract itself that duties can be delegated. If they do, that provision will generally be enforced, and the duties can be delegated even if they would seem too personal or unique to be effectively delegated under the rules discussed above.

Contracts may also prohibit the delegation of duties through "no delegation clauses." Such provisions will also generally be enforced. A "no delegation clause" might result in a duty that would normally seem to be delegable not being delegable. For example, a duty to build a relatively simple structure like a latrine would probably be delegable in most cases. But if a contract provision forbids delegation of that duty, courts are likely to enforce the provision. It appears that some jurisdictions do not interpret no delegation clauses to forbid the delegation of completely non-personal duties, like the duty to pay money. And as noted in Section 11.3b above, many jurisdictions interpret a contract provision saying that the "contract shall not be assigned" to mean only that the duties cannot be delegated.

******* ***CASE STUDY 251***

FACTS Vannpok's computer broke. So he took it to the Cambodian Technologies Computer Shop. The Shop found several things wrong with the computer. The Shop said that the computer would not be too difficult for the Shop to fix. Cambodian Technologies and Vannpok made a contract under which the Shop agreed to repair the computer for a certain price within one week.

A few days later, the Shop became extremely busy. It decided to delegate some of its duties to repair computers, because otherwise it would have trouble completing all its work on time. It attempted to delegate its duty to repair Vannpok's computer to Phaveng, an attorney who was a friend of the Shop's owner--but who had no skill or experience with computer repair! Vannpok objected.

QUESTION OF LAW Was the Shop's attempted delegation to Phaveng of the Shop's duty to repair Vannpok's computer effective?

DECISION Probably not. Although the duty to repair the computer was probably delegable, it is unlikely that it could properly be delegated to Phaveng, who was not competent to repair computers.

Duties can generally be delegated if the obligee will still receive the substantial benefit of his bargain. To determine whether a delegation is effective, many jurisdictions ask whether the duty can be delegated at all,

and then whether it has been effectively delegated in the particular situation involved.

In this case, the Cambodian Technologies Computer Shop tried to delegate its duties to perform relatively straightforward repairs on Vannpok's computer to Phaveng. These duties were probably delegable in general. They were relatively straightforward, and there is no indication that the obligee Vannpok had a substantial interest in having only the Shop do the work. However, it seems that Vannpok will probably not receive the substantial benefit of his bargain. This is because the particular delegatee the Shop chose--Phaveng--was an attorney with no skills or experience in fixing computers. Therefore, this attempted delegation is probably not effective, and Vannpok could refuse to accept performance from Phaveng. Of course, as the delegator, the Shop remains liable in any case.

11.5 A Third Party Beneficiary May Be Able to Enforce a Contract, Even Though He Is Not a Party to That Contract

It is also possible for a third party to gain contract rights under a contract between two other parties at the time that contract is made, even though the third party is not a party to the contract. This occurs frequently, and the rights of such third party beneficiaries can be very important.

This Section will explain some basic aspects of third party beneficiaries. In particular, it will discuss:

(1) when third party beneficiaries gain the rights to enforce contracts (Section 11.5a);

(2) particular situations where third party beneficiaries may exist (Section 11.5b); and

(3) the rights and duties of parties where there is a third party beneficiary (Section 11.5c).

11.5a An Intended Third Party Beneficiary Can Enforce a Contract, but an Unintended or Incidental Beneficiary Cannot

Not every third party who will receive some benefit from the performance of a contract gains rights under that contract. In fact, many jurisdictions say that a third party gains such rights only where the third party was an intended beneficiary. That means that the parties to the original contract intended that the third party have the right to enforce their contract. But if a third party is merely an incidental or unintended beneficiary, he cannot enforce the contract.

There are also two other important terms to know in the area of third party beneficiaries. The contract party making the promise whose performance will benefit the third party beneficiary is called the promisor.

The contract party receiving the promise whose performance will benefit the third party is called the promisee. Of course, most contract parties are both promisors and promisees. The use of these terms here is simply to help explain the relationship of the contract parties to each other and to the third party beneficiary.

The most important issue courts must decide with respect to third party beneficiaries is whether a third party really was an intended beneficiary or not. Sometimes this is easy.

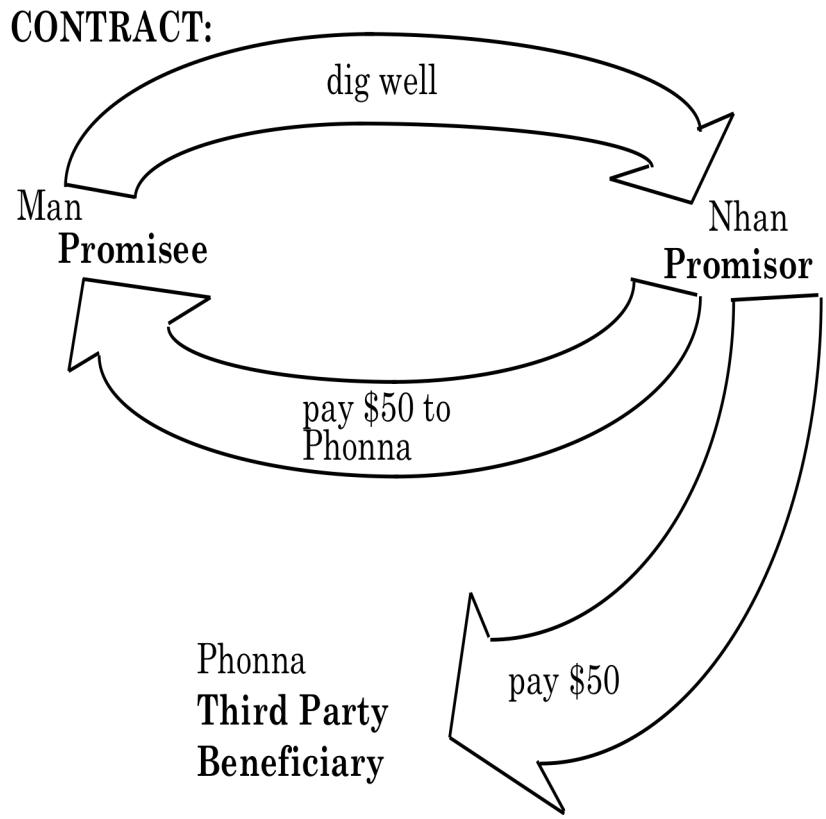
For example, suppose Man and Nhan made a contract under which Man agreed to dig a well for Nhan, and in exchange Nhan agreed to pay $50 to Phonna. In this case, Phonna is not a party to the contract between Man and Nhan. He is a third party. However, it is clear that the contract parties intended to benefit him in their contract, since they agreed that Nhan would pay Phonna $50. So Phonna is an intended third party beneficiary of this contract, and Phonna can enforce the contract against Nhan. In this situation, Nhan would be the promisor with regard to this promise, since it is her promise that will benefit Phonna. Man would be a promisee, since he received the promise.

However, suppose that the well Man agreed to dig would also benefit Nhan's neighbor Banh, because it would make Banh's land more valuable if there was a well next to it. Banh is probably an unintended beneficiary. This is because, even though the performance of the contract will benefit Banh, there is nothing to show that the parties' intent in making the contract was to benefit Banh.

The following chart shows how intended third party beneficiaries may be created.



Illustration: How Third Party Beneficiaries Are Created



Of course, in this illustration, Man is the "promisee" and Nhan is the "promisor" with regard to the promise to pay $50--the promise that benefits Phonna. With regard to the promise to dig the well, Man is the promisor, and Nhan is the promisee.

Sometimes it is not so easy to tell if a third party beneficiary is intended or not. Suppose that Man, instead of agreeing to dig a well, agreed to be a night guard for Nhan. In exchange, Nhan promised to pay Man a certain salary. Suppose also that Nhan's friend Phonna is at Nhan's house one night, when a robber overpowers Man and robs Phonna. Phonna might claim to be an intended beneficiary of the guard contract between Man and Nhan, since the main purpose of the contract was to provide security at Nhan's house. However, based on these facts, a court would probably find that Phonna was not an intended beneficiary. This is because there is nothing to show that Nhan and Man intended to benefit Phonna in particular. As an unintended or incidental beneficiary, Phonna cannot enforce the contract in this situation.

Traditionally, many jurisdictions have said that there are two main kinds of intended beneficiaries:

(1) donee beneficiaries, and

(2) creditor beneficiaries.

Different jurisdictions have not agreed about exactly which beneficiaries fall into these categories. But basically, donee beneficiaries exist where the promisee is trying to make a gift to the beneficiary. Creditor beneficiaries exist where the promisee is trying to fulfill some existing legal duty that he owes or believes he owes to the beneficiary. Both donee and creditor beneficiaries can enforce contracts.

It appears that the main reason that jurisdictions make this donee/creditor distinction is that they may apply different rules about when the rights of the beneficiary "vest" in the two different situations. To "vest" basically means to become the present property of the holder of the right. The distinction might also affect what remedies will be available if the promisor fails to perform. A creditor beneficiary can generally sue the promisor or the promisee (under the prior legal obligation). But a donee beneficiary can generally enforce only the promise of the promisor against that promisor (since there is generally no prior legal obligation between the promisee and beneficiary in that case). This will be further discussed in Section 11.5c, below.

11.5b Particular Situations Where Third Party Beneficiaries May Exist

There are a number of important examples of situations where intended beneficiaries may exist. This Section will discuss a few of these situations.

One situation where third party beneficiaries may exist is where loan creditors like banks become beneficiaries of contracts in which a party assumes a debtor's duty to repay to the creditor a loan secured by a mortgage or other security interest in property. Some jurisdictions limit the amount that creditors can recover from debtors in this situation.

For instance, in Case Study 250, Pheap promised in his contract to buy Chhean's land that he would repay money Chhean owed to the Pailin Bank under a loan agreement secured by a mortgage. In that situation, Chhean delegated his duties to Pheap. The Bank was an intended third party beneficiary of the property sale contract. This is because Chhean (the promisee) and Pheap (the promisor) clearly intended to benefit the Bank when they made their agreement. Of course, the Bank was a creditor beneficiary, since Chhean obviously made the agreement partly in order to satisfy the existing debt he had to the Bank, and not as a gift to the Bank. So the Bank could enforce promises to repay the debt against Pheap or Chhean.

However, it is important to look closely to see whether a party in a situation like Case Study 250 has really "assumed" the loan obligations, or whether he has bought property "subject to" the loan obligations. If a buyer buys property "subject to" a secured loan of the seller, many jurisdictions say that the buyer is not personally liable for the debt to the creditor. The buyer will probably still lose the property if the debt is not paid according to the loan contract. But the buyer will not be liable beyond that for the amount of the debt which is still owing to the creditor, if any.

Another important type of intended beneficiary is a third party beneficiary under a life insurance policy. These kinds of policies can help to protect people from financial difficulties in the event of the death of someone on whom they depend.

******* ***CASE STUDY 252***

FACTS Kheng buys a life insurance policy from the Bad Day Insurance Company. The policy basically states that, in the event of Kheng's death during the term of the policy, Bad Day will pay Kheng's beneficiaries $50,000. Kheng designates her two young children as her beneficiaries.

Unfortunately, Kheng dies while the insurance policy is in force. The Insurance Company claims it has no obligation to pay, and Kheng is not alive to enforce the contract she made. But Kheng's children say they have the right to enforce the policy against the insurance company.

QUESTION OF LAW Can Kheng's children enforce this insurance policy against the Bad Day Insurance Company, even though the children are not parties to the contract?

DECISION Yes. Kheng's children can enforce the insurance policy against Bad Day because they are third party beneficiaries of the contract.

Third party beneficiaries can enforce contracts which are intended to benefit them, even though they are not parties to the contracts. In this case, Kheng and the Bad Day Insurance Company made a contract which basically said that, if Kheng died during the term of the policy, Bad Day would pay $50,000 to Kheng's beneficiaries--her children. Kheng did die while the policy was in force, but Bad Day refused to pay.

In this situation, Kheng's children can enforce the insurance contract even though they were not parties to it. That is because the children are intended third party beneficiaries of the contract. The promisee Kheng and the promisor Bad Day clearly intended to benefit the children by making the life insurance contract, since the main reason for the contract was to protect Kheng's beneficiaries in the event of her death. Kheng's children are donee beneficiaries. So they can enforce the contract against Bad Day, and collect the proceeds of the policy.

Other types of contracts which may protect children as third party beneficiaries are divorce agreements and child support agreements. These agreements may provide that one party will provide certain payments or other performances to the children of a couple who will no longer be married. In these cases, the parties clearly intend that the children named in the contract will receive certain benefits. And the children who are named are generally third party beneficiaries who can enforce the promises against the promisor.

Sometimes the issue of third party beneficiaries can arise in contracts where the government is a party. Often, governments make contracts with private parties to perform activities whose main purpose is to provide benefits to a certain group of citizens. In these cases, citizens in these groups might argue that they were intended third party beneficiaries, so they should be able to enforce the contracts! For example, a government might hire a private company to provide job training to some of its poorest citizens.

In these kinds of cases, the general rule seems to be that such citizens do not have the right to sue such promisees if they fail to perform their contracts with the government. It appears that courts feel the parties do not generally intend citizens to have that right.

However, some jurisdictions say that citizens may actually have such a right in two special cases. These are where: (1) the contract actually says they have that right; and (2) the government has a duty to provide the service it has hired the private company to provide, such as the duty of a municipality to keep its streets in good condition. For example, suppose a person is injured because a private company fails to perform a contract to maintain streets in a situation like that. Some jurisdictions would allow the injured person to sue the government or the private company as a third party beneficiary. Consider also the following Case Study.

******* ***CASE STUDY 253***

FACTS The What Is Chicken? Company is about to open a new chicken processing plant in a large town in Kampot province. As part of its preparations to open, the Company makes a contract with this town to use the town's sewage system to carry away the waste that will be produced by the plant.

A clause in the contract requires the Company to remove certain dangerous types of waste before the Company's waste reaches the town's sewage system. The reason for this clause is to protect the landowners and other citizens who are farther down the sewage system from the plant from the harmful effects of these dangerous kinds of waste.

A few months after the plant opens, a local farmer named Meng notices that many of his animals are sick. After examining the animals, Meng believes that the reason for these illnesses is that the new chicken plant

has been failing to remove the dangerous kinds of waste that it promised to remove in its contract with the town. Meng asks the manager of What Is Chicken? to comply with the contract, and to compensate him for the damage he has suffered. The Company refuses. Meng asks the court for help.

QUESTION OF LAW Can Meng enforce the What Is Chicken? Company's promise to remove dangerous parts of waste which the Company made in its sewage disposal contract with the town?

DECISION Yes, in some jurisdictions. Some jurisdictions would say that downstream land owners like Meng were intended third party beneficiaries of the sewage disposal contract the town made with What is Chicken?, and that Meng could enforce the Company's promise to remove the dangerous wastes.

Third party beneficiaries can enforce contracts which are intended to benefit them, even though they are not parties to the contracts. In this case, the What Is Chicken? Company made a contract with a town to use the town's sewage system to dispose of waste from its new plant. The Company agreed in the contract to remove certain dangerous wastes before they got to the town's sewage system, in order to protect landowners and others downstream from the plant.

However, Meng believes that the Company has not removed these wastes as required by the contract, and that that is the reason some of Meng's animals are ill. Some jurisdictions would say that Meng is an intended third party beneficiary of this contract, and that Meng can therefore enforce against the Company its promise to remove the dangerous waste. Meng might be able to recover from the town as well. This is because the town probably has a duty to the public to protect them from these kinds of dangerous waste.

11.5c Rights and Duties Where There Is a Third Party Beneficiary

As noted above, where there is an intended third party beneficiary to a contract, that third party can enforce the contract. This means that the third party can enforce the contract promise against the promisor, whether the third party is a creditor beneficiary or a donee beneficiary. In general, the beneficiary would probably have the range of potential remedies discussed in Chapter 10 ("Remedies").

If the third party is a creditor beneficiary, the third party may be able to recover against the promisee also. This is because of the original legal duty of the promisee that motivated the promisee to make the contract that benefits the beneficiary. If the third party does bring legal action against the promisee based on the original obligation, then the promisee will likely be damaged because of the promisor's failure to perform his promise. In that situation, the promisee can take legal action against the promisor.

Of course, if the third party is a donee beneficiary, it would appear that he cannot recover against the promisee, since the promisee has no legal obligation to the beneficiary. It might also seem that the promisee might not be able to recover much against the promisor in a donee beneficiary case. That is because the promisee is unlikely to have many damages where he was simply trying to give the beneficiary a gift. However, many common law jurisdictions will allow the promisee to specifically enforce the promise on behalf of the donee beneficiary, and to get restitution from the promisor.

For instance, recall the example in Section 11.5a above in which Man agreed to dig a well for Nhan, and in exchange Nhan agreed to pay $50 to Phonna. Phonna is an intended third party beneficiary of this contract. So Phonna gains the legal right to enforce the contract against the promisor Nhan.

Suppose Man asks Nhan to pay Phonna because of a debt Man owes to Phonna from the past. In that case, Phonna is a creditor beneficiary. If Nhan fails to pay Phonna, Phonna can bring legal action against Nhan. Phonna can also sue Man, because of the old debt. And if Phonna does bring a claim against Man because of Nhan's failure to pay, Man can bring an action against Nhan for the damage caused to Man.

Now suppose Man asked Nhan to pay Phonna simply because Nhan likes Phonna and wants to give him a gift. Phonna would be a donee beneficiary. Phonna could enforce Nhan's promise against Nhan. Phonna would probably have nothing to enforce against Man, who was simply trying to give him a gift. However, in many common law jurisdictions, Man could enforce Nhan's promise against Nhan. Even though Man would be unlikely to have much in damages, he could ask a court for restitution of any benefits he had given to Nhan. He could also ask for specific performance of Nhan's promise to pay Phonna.

One very important issue about the rights of third party beneficiaries is whether the promisor and promisee can change those rights after they are created. This depends on when the rights "vest." As noted above, to vest basically means to become the present property of the holder of a right. It means not only that the right is enforceable--which happens as soon as the contract is formed--but that it cannot generally be taken away by other parties. So if the rights of a third party beneficiary have vested, then the promisor and promisee cannot change them to the detriment of the beneficiary without the beneficiary's consent.



Different jurisdictions have different rules about when vesting occurs. So it is important to look closely at the relevant law. Potential times when such rights may vest include at the time:

(1) the contract is made;

(2) the beneficiary learns of and agrees to accept the benefits;

and (3) the beneficiary justifiably relies on the promise, such as by bringing a lawsuit about the promise.

The time of vesting may vary based on whether the beneficiary is a donee or a creditor. In some jurisdictions, the rights of donee beneficiaries vest at the time the contract is made, or as soon as the beneficiary learns of and agrees to accept the benefits, whereas the rights of creditor beneficiaries vest at the time they justifiably rely. Justifiable reliance in this situation would be similar to the kind of reliance discussed with respect to promissory estoppel, which was explained in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

Some jurisdictions say the rights of minors vest earlier, often at the time of the contract. This is because it can be unfair to expect minors to learn of and agree to the benefits.

Finally, the promisor and promisee can agree in the contract that the rights they are creating cannot be changed without the consent of the beneficiary. Such clauses are enforceable.

*** ***CASE STUDY 254***

FACTS Jim and Sam make a contract together. In the contract, Jim agrees to pay Sam $1,000. In exchange Sam agrees to supply new commercial law books to Sathya, Sovannara, Charavuth, Neam, Sethik, Sorit, Phally, Sarun, Much, and Saray, so that they can use the books in their important legal development and reform work. Jim immediately informs these ten people about how he has arranged to get the books for them, and they all agree to accept the books.

Jim pays Sam $1,000 as the contract requires. However, Sam does not supply any law books. Meanwhile, Jim has gone to Thailand and no one can find him. The ten people above ask Sam for the books. But Sam says that, just before Jim went to Thailand, he and Sam agreed to rescind the contract, and that in any case, Sam no longer works in law.

The ten people ask their attorney what they can do. The attorney finds out that they live in a jurisdiction where vesting occurs when a third party beneficiary justifiably relies on a promise, or brings a lawsuit about it, or agrees to accept the benefits of it.

QUESTION OF LAW Can the ten people above enforce Sam's promise to supply them with law books?

DECISION Yes. The ten people above can enforce Sam's promise, because their rights under the contract between Jim and Sam vested before any potential rescission could have occurred.

Third party beneficiaries can enforce contracts which are intended to benefit them. Once these third party rights have vested, they cannot be changed by the parties to the contract. In this jurisdiction, vesting occurs when a third party beneficiary justifiably relies on a promise, or brings a lawsuit about it, or agrees to accept the benefits of it.

In this case, Sam and Jim made a contract under which Jim would pay $1,000 to Sam. In exchange, Sam was to supply law books to Sathya, Sovannara, Charavuth, Neam, Sethik, Sorit, Phally, Sarun, Much, and Saray. This made these ten people third party beneficiaries. Jim told the beneficiaries about the promise of Sam, and they all agreed to accept the books. However, although Jim paid the money to Sam, Sam never provided the books as the contract required. Instead, Sam claimed that he and Jim had rescinded the contract just before Jim left for Thailand.

In this situation, the ten people above can enforce Sam's promise to supply them with law books, even if what Sam claims is true. The reason is that Jim told the beneficiaries about the promise of Sam, and they all agreed to accept the books, before Sam claims the rescission occurred. In this jurisdiction, that meant that the rights of the third party beneficiaries vested. After vesting, the rights could not be taken away by a modification or rescission of the agreement by the promisor and promisee. In this case, the ten beneficiaries can recover from Sam.

A final important issue is the defenses of the promisor in the event that a third party beneficiary tries to enforce his rights. In general, the promisor has all the defenses against the third party which the promisor would have if the promisee sued the promisor under the original contract. That means that, if the third party beneficiary tries to enforce the contract against the promisor, the promisor can defend himself on the basis of the full range of formation problems discussed in Chapters 2-7 of this text. The promisor can also defend himself on the basis that the promisee did not perform as required by the contract, or that some other event caused the promisor's duty to perform to not become due or to be discharged. These issues were discussed in detail in Chapter 9 ("Performance and Discharge of Duties").

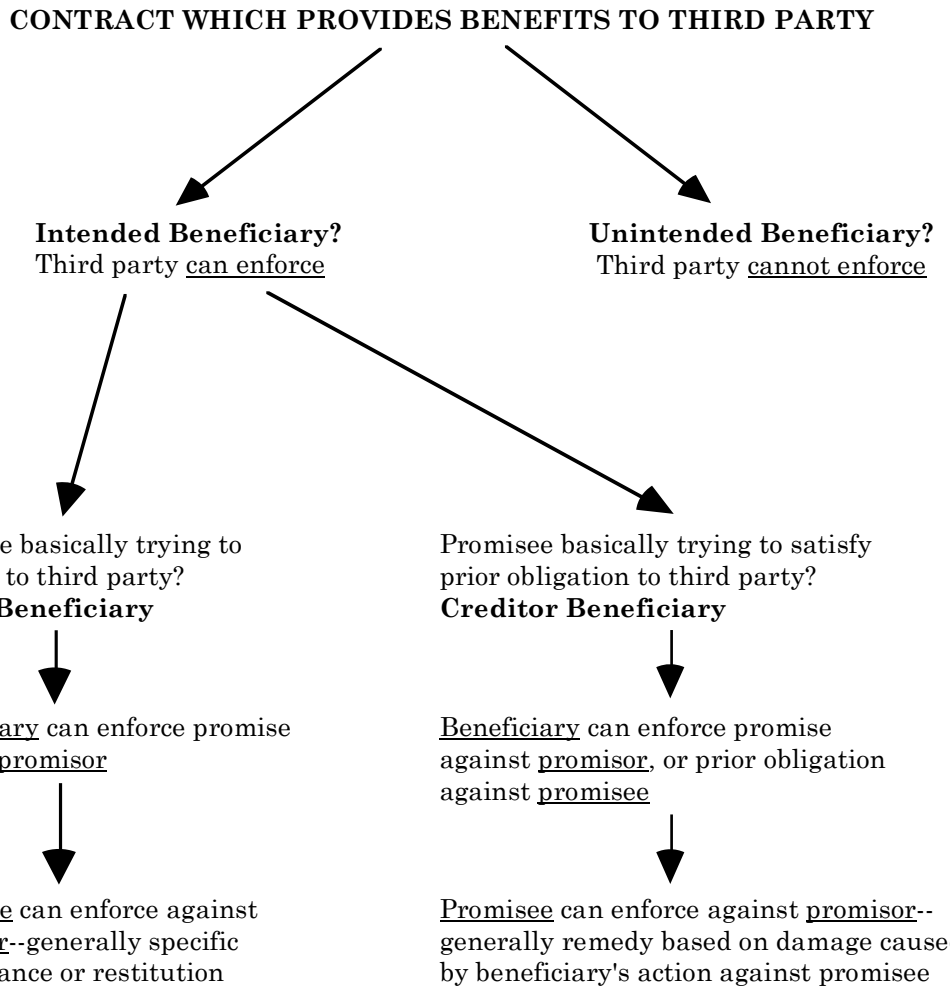
There are limits on the potential defenses of the promisor. If the beneficiary's rights have vested, the promisor cannot argue that the original contract has been rescinded or modified. In addition, the promisor cannot use defenses based on transactions between the third party beneficiary and

the promisee. Such transactions would exist primarily where there was a creditor beneficiary.

For instance, in the well digging example above, Man agreed to dig a well for Nhan, and in exchange Nhan agreed to pay $50 to Phonna. Suppose Nhan failed to pay Phonna, and Phonna tried to enforce Nhan's promise against Nhan. Nhan could defend herself on the basis that there was some formation problem, such as legality or duress. Nhan could also use the defense that her duty to pay never became due because Man failed to dig the well, and that the digging of the well was a condition precedent to Nhan's duty to pay. But she not could not raise issues related to any transactions between Man and Phonna.

The following chart illustrates some of the basic rules discussed above about the rights and duties of the parties in a third party beneficiary situation.

Illustration: Basic Rights and Duties Where There Are Third Party Beneficiaries



*** ***ADDITIONAL REFERENCE:*** Chapters 2-7 discuss various problems in the formation of contracts; Chapter 7 ("Other Contract Formation Problems"), Section 7.8 discusses promissory estoppel; Chapter 9 ("Performance and Discharge of Duties") discusses when duties become due, and when they are discharged; and Chapter 10 ("Remedies") discusses remedies that may be available where parties fail to perform contracts.

11.6 Third Party Rights and Duties in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the Cambodian law tradition and the civil law tradition to third party rights and duties seem generally compatible with the approach discussed in this Chapter, although there are some differences in the ways the different traditions discuss the issues.

*** ***CAMBODIAN LAW PERSPECTIVE:*** The current Contract Law of Cambodia (Decree #38D (1988)) contains a number of provisions relevant to third party rights and duties. They seem generally compatible with the ideas discussed earlier in this Chapter. Some are briefly discussed below.

Article 22 of Decree #38D states that a "contract binds only the parties to the contract." This is consistent with the general free market rules about third parties, as discussed above.

Chapter 2, Section 1 deals with sales contracts. A number of articles pertain to objections by third parties who claim some right in the property being sold. Article 41 notes that third parties lose their rights to object to real property sales at the time the sale deed is certified and registered, and to personal property sales at the time of delivery, or at the time of deed certification, where that practice is used. Articles 43-46 deal with the seller's duties to protect the buyer from claims by third parties. Article 48 gives the buyer the right to rescind and get damages where the seller obtained the property through a crime. Article 52 provides that a buyer who has the sale item can suspend payment to the seller in the event of a third party claim until that claim is resolved.

Chapter 2, Section 8 regulates leases. Article 103 provides that lessors must "protect" lessees from the claims of third parties who may assert rights in leased property, such as a "right of mortgage."

Chapter 2, Section 9 governs suretyship contracts. Article 112 defines a suretyship contract as one in which "a third party called a 'surety' agrees with the creditor by contract to undertake or to perform the obligations of the debtor in the event that the debtor fails to perform his/her obligations to the creditor."

*** ***CIVIL LAW PERSPECTIVE:*** The civil law approach to third party rights and duties appears to be generally compatible with the one discussed in this Chapter. Of course, the exact rules about third party rights and duties vary from one jurisdiction to another, so it is always important to check the relevant local law.

It appears that civil law jurisdictions apply doctrines which are comparable to the concepts of assignment of rights and delegation of duties which are discussed in this Chapter. For example, in France, the doctrine of *cession de créance* which is contained in the *Code civil* appears to be similar in many ways to the ideas about assignment of rights which were discussed in this Chapter. This doctrine allows parties to transfer contract rights to third parties. In order for such a transfer to be effective, the obligor must receive notice of it, or accept the transfer in a certified instrument. The *Code* basically provides that the transferor warrants that the right being transferred actually exists at the time of transfer. However, the transferor does not generally warrant that the obligor is solvent.

Civil law jurisdictions may also apply doctrines which are comparable to the idea of third party beneficiaries as discussed in this Chapter. For example, in France, the *Code civil* contains the doctrine of *stipulation pour autrui*. This important doctrine appears to basically say that, where it is clear that the parties to a contract intended in their contract to benefit a third party, the third party has the right to enforce the promise of that benefit against the promisor. This kind of *stipulation* can be express or implied. It appears to be required that the third party who will be benefited show an intention to accept the benefit--such as by simply claiming the benefit--in order to recover. It also seems that, until that showing occurs, the contract party receiving the promise has the power to revoke the *stipulation*. This doctrine appears to apply in cases related to life insurance, the assumption of mortgages, and other important situations.

With regard to enforcement under the doctrine of *stipulation pour autrui*, the party who is to provide the benefit to the third party can generally make any defenses against the third party that he would have had against the other party to the contract. And the other party to the contract can also enforce the promise against the party who made the promise, with the usual range of potential remedies, particularly specific performance, which might be more useful in cases where the party receiving the promise has no real damages.



11.7 Questions for Review

CHAPTER 11 -- QUESTIONS FOR REVIEW

1. In what situations could third parties have rights or duties under a contract even though they are not parties to the contract?

2. What are the differences between the situation where an assignment of rights or delegation of duties occurs, and the situation where a novation occurs?

3. Why does the law say that third parties can have rights and duties in the situations discussed in this Chapter?

4. What is an assignment of rights?

5. What are some key limits on what contract rights can be assigned?

6. What are some important effects of an assignment?

7. When and how can an assignment be terminated?

8. What is a delegation of duties?

9. What is required for an effective delegation to occur?

10. When can third party beneficiaries enforce contracts?

11. What are some important examples of situations where intended third party beneficiaries may exist?

12. What are some key rights and duties of the promisor, promisee and third party where an intended third party beneficiary exists?

13. Is the Cambodian law approach to third party rights and duties generally compatible with the approach discussed in this Chapter?

14. Is the civil law approach to third party rights and duties generally compatible with the approach discussed in this Chapter?

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GLOSSARY

Below are basic definitions of some of the more important terms and phrases used in this book, with the number of the principal Section(s) discussing each term or phrase noted in parentheses at the end of each definition.

acceptance — An acceptance is an offeree's indication of agreement with an offer (2.7).

accord and satisfaction — An accord and satisfaction occurs where the parties to an existing contract make a new contract that substitutes a different duty for a duty owed under the old contract (the "accord"), and then that new duty is actually performed as required by the new contract (the "satisfaction") (9.7d).

account stated — An account stated is an agreement between a creditor and a debtor that a particular sum is the correct amount the debtor owes to the creditor (9.7f).

adhesion contracts — Adhesion contracts are contracts written completely by a party who has much greater bargaining power, and presented to the other party in circumstances where there is no real opportunity to negotiate about the terms, which are usually standardized, difficult to understand, very favorable to the stronger party, and in small print (7.7b).

anticipatory repudiation — An anticipatory repudiation is generally considered to be a statement by one contract party to another contract party that clearly shows that the first party does not intend to perform a contract duty in the future when that performance is due (9.4d).

assignment of rights An assignment of rights is a present-time transfer of contract rights from one party to a contract to a third party (11.3a).

bilateral contract Under common law, a bilateral contract is a contract in which the parties exchange promises to do things (1.3b).

breach of contract A breach of contract is a failure to perform a contract promise without any legal excuse (9.4c).

capacity Capacity is a person's legal power or qualification to do what adult persons generally have the legal power or qualification to do (4.1).

condition In contract law, a condition is a particular future event which is not certain to occur, but whose occurrence will affect the formation or performance of a contract (2.6b); in particular, a condition is an event which must occur or be excused for a contract duty to become due for performance, or for that duty to be terminated if the duty is already due (9.3a).

consideration Consideration is the new legal detriment to a party to a contract, which generally means what each party does or promises to do in exchange for a promise or performance from another party (3.2).

contract A contract is an agreement the law will enforce (1.3a).

counter-offer A counter-offer is an offer that the original offeree makes back to the original offeror, in response to the original offer (2.5b).

delegation of duties A delegation of duties is a transfer of contract duties from one party to a contract to a third party (11.4a).

disaffirmance Disaffirmance is one party's repudiation of or refusal to abide by a contract--that is, the party's proper indication that she will avoid the contract (4.4a).

discharge A discharge is basically an ending of a duty to perform under a contract (9.2).

duress Duress is the use of an improper threat to induce a party to do something the party would not otherwise do (7.5).

duty A duty is basically a legal obligation to do or not do something (1.1c).

easement An easement is basically a right to use (but not possess) the real property of another person in a specified way, such as a right to cross the property to reach a road (6.3b).

estoppel Estoppel generally occurs where a court says a party cannot make a particular legal claim or argument because of some action of that party that is inconsistent with the claim or argument (9.4i).

exculpatory clause An exculpatory clause is a clause that attempts to relieve a person of liability for future harm, generally for torts (5.4g).

executed contract An executed contract is one that has been fully performed by all parties to the contract (1.3c).

executor or administrator of an estate An executor or administrator of an estate is someone who gathers the assets of a recently deceased person, pays the debts of the deceased person from those assets, and then distributes what remains to the legal heirs (6.3d).

executory contract An executory contract is one that has not yet been fully performed by all parties (1.3c).

expectation damages Expectation damages are damages that try to place a party injured by a contract breach as close as possible to the position she would have occupied if the parties had fully performed the contract (10.2).

express contract An express contract is one made in words (1.3d).

forfeiture A forfeiture is basically a loss of something to another person because of a breach of contract, or other failure to act as required by law, with no adequate legal remedy for the party suffering the loss (9.3c).

formal contract A formal contract is one made under seal (1.3d).

gambling agreement A gambling agreement is an agreement in which parties stand to win or lose some consideration based on the occurrence of some future event over which they do not have complete control, and which therefore contains an element of chance (5.3b).

good faith Good faith is almost impossible to define exactly, but it generally includes a party's honest belief and conduct, and a lack of malice or intent to seek an unfair advantage (3.6a).

good faith and fair dealing The duty of good faith and fair dealing basically requires a party to a contract to be honest and not seek unfair advantage over the other party (good faith), and to follow reasonable standards of fair conduct in the type of contract the parties made (fair dealing) (8.3j, 9.5c).

hold harmless clause A hold harmless clause is basically one in which a party agrees to be responsible for the potential legal liability of another party (8.3i).

implied contract An implied contract is one made through the conduct of the parties (1.3d).

jurisdiction A jurisdiction is, among other things, a geographical unit in which courts apply a particular set of legal rules (1.1c).

lapse A lapse is a termination of some right or power because of a failure to exercise that right or power within some period of time, or because some particular thing fails to happen (2.6a).

lease A lease is an agreement to rent property; that is, an agreement in which one party promises to allow another party to possess (but not own) real or personal property for a certain amount of time (6.3b).

licensing statute A licensing statute is a statute which requires that some competent authority (generally a government body) formally give permission--a license--in order for someone to do something (5.3d).

liquidated damages see stipulated or liquidated damages.

material change A material change is a new or different term which gives one party significantly greater benefits, rights, or advantages (and the other party less) than she had before (2.10c).

material term A material term in a contract is basically one that is important to a party's decision to make or not make a contract (2.3b).

merchant A merchant, for the purposes of contract law, is basically a person who normally deals in goods of the kind involved in the transaction being analyzed (2.10c).

misrepresentation A misrepresentation is a statement that is not in accord with the facts (7.4).

mistake A mistake is a belief that is not in accord with the facts (7.3).

money damages Money damages is an amount of money that a court or arbitrator orders one party to a legal dispute to pay to another party to the dispute because of some injury or loss the first party caused to the second party (10.1).

mortgage A mortgage is an interest in land which secures (or guarantees) the performance of some obligation, usually the repayment of a debt (6.3b).

mutual rescission A mutual rescission is basically the cancellation of a contract by agreement of the parties (3.7a, 9.7a).

nominal damages Nominal damages are a small sum set by the court and awarded to a party seeking damages principally to show that another party has committed a legal wrong against the first party, even though the party seeking damages has proved no real harm (10.5b).

novation A novation is generally defined as an agreement to substitute a new party for one of the parties to an existing contract, and to immediately discharge the duties under the original contract (9.7e).

objective interpretation — An objective interpretation of an agreement is one based on what reasonable people normally intend in situations similar to the situation of the parties (8.3b).

offer — An offer is a proposal to make a contract (2.2).

offeree — An offeree is a party to whom an offer is made (2.2).

offeror — An offeror is a party who makes an offer (2.2).

option contract — An option contract is a contract whose purpose is to keep an offer open (2.4b).

oral contract — An oral contract is one made using spoken words (1.3d).

promise — In a contract, a promise is basically a statement that a party will perform a contract duty when that performance is due (9.3a).

promissory estoppel (detrimental reliance) — Promissory estoppel (detrimental reliance) is a doctrine some common law jurisdictions use to avoid injustice by enforcing promises on which parties justifiably rely, even though there is no valid contract (2.4e, 7.8a).

prospective inability or unwillingness to perform — A prospective inability or unwillingness to perform exists where circumstances provide a reason to believe that it is likely that a party will be unable or unwilling to perform a contract duty (9.4e).

public policy — Very generally, public policy is the promotion of the common good and well-being of society (5.4a).

punitive damages — Punitive damages are damages a court awards in order to punish a party who has committed some civil wrong, and to deter her and others from committing such wrongs in the future (10.5d).

quasi-contract — Quasi-contract is a doctrine under which courts impose contract obligations on a party, even though they cannot enforce a contract for the party seeking help, in order to avoid unjust enrichment (1.5a).

ratification Ratification is a proper confirmation that a party intends to be bound by a voidable contract, despite that party's right to avoid it--basically the opposite of disaffirming a contract (4.4b).

rejection A rejection is a refusal to accept an offer (2.5a).

release A release is a document signed by a party in which that party discharges a duty that is owed to him (9.7b).

reliance damages Reliance damages are damages that try to place a party injured by a contract breach or failure to perform a promise as close as possible to the position she occupied before the contract or promise was made (10.3).

restitution damages Restitution damages are damages that try to compensate a party for the value of the benefit she has given to another party, in order to prevent unjust enrichment (10.4).

restraint of trade Agreements that unreasonably restrain trade are basically those that harm competition or unreasonably restrict a party's freedom to conduct his trade or business as he chooses (5.3e).

revocation A revocation is the act of withdrawing an offer (2.4a).

right A right is basically the legal ability to do or not do something, including the ability to control the acts of others (1.1c).

severance Severance is a court's removal of unenforceable parts of an agreement, leaving behind an agreement the court will enforce (5.5b).

simple contract A simple contract is one not made under seal (1.3d).

specific performance An order for specific performance occurs where a court orders a party to actually perform according to the terms of a contract (10.7a).

statutes of limitation Statutes of limitation are laws which specify how much time a party has to make a certain kind of legal claim in court after the claim arises (3.8d).

stipulated or liquidated damages clause — A stipulated or liquidated damages clause is a contract provision that specifies the amount of damages one party must pay another party in the event that the first party breaches the contract (10.5a).

subjective interpretation — A subjective interpretation of an agreement is one based on what the parties themselves actually intended in their particular situation (8.3b).

suretyship contract — A suretyship contract is an agreement in which one person (the surety) agrees to become responsible for the debts or obligations owed by a second person (the debtor or promisor) to a third person (the creditor or promisee); the surety agrees to perform if the second person fails to pay the debt or meet the obligation (6.3d).

tender of performance — A tender of performance is basically a party's offer to perform his existing contract duties, with the present ability to do so (9.4g).

tort — A tort is basically a non-contractual civil wrong for which the wronged party--not society--can seek compensation (5.4b).

unconscionable agreements — Unconscionable agreements are basically agreements whose process of formation or actual provisions are so unfair to one party that they shock the conscience of the court (7.7a).

undue influence — Undue influence is the improper influencing of a party to make an unfair contract, often through a relationship of trust or confidence, even though no threats are made (7.6).

unilateral contract — Under common law, a unilateral contract is a contract in which the parties exchange a promise for an act (1.3b).

usurious agreement — A usurious agreement is a loan agreement in which the amount of interest charged is higher than the rate allowed by law (5.3c).

valid contract — A valid contract is a contract that is enforceable by all parties to the contract (1.3a).

void "contract"	A void "contract" is an agreement that is not enforceable by anyone (1.3a).
voidable contract	A voidable contract is one that is enforceable, but which at least one party to the contract can avoid (1.3a).
waiver	A waiver is often defined as the intentional relinquishing or giving up of a legal right that is known by the holder of that right (9.4i).
written contract	A written contract is one made using written words (1.3d).

INDEX

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would mean that Koprey are discussed in Chapter 3, Section 3.5, and in Chapter 9, Section 9.6.

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