

2-1 Offer & Acceptance: Creation of Offers

Hot Debate: Celia had worked after school since she was 14 to save money for a car. When she turned 18, she bought a VW. Two weeks later she was driving a group of friends to school. The car stalled at a stop light and people behind her began honking. Celia became frustrated when the car wouldn't start and said, "I'll sell this thing for \$300 right now!" Joan gathered three hundred dollars from her purse and handed it to Celia stating, "I accept, here's your money." Should Celia be bound because the literal meaning of her words suggests she intended to sell the car? Should Celia not be bound to sell the car because the circumstances (new car stalls and people are honking) suggest that she did not intend to sell?

What Is A Contract?

What's Your Verdict? Pedro and Seamus were chatting during the break between classes. "Remember 'Great Moments in Sports', the video that I showed you last week?" asked Pedro. "You thought it was great and said you wished it was yours. I'll let you have it for fifteen bucks. Want it?" "Sure!" Seamus answered. "Bring it to school tomorrow, okay?" Did the two friends create a contract?

A **contract** is an agreement that courts will enforce. Contracts between two parties are the basis for all economic activity. They are the legal links between the individuals and companies producing and consuming goods and services. There are five major requirements that must be satisfied before courts will treat transactions as contracts:

Offer and Acceptance. There must be a serious, definite offer to contract. The terms of the offer must be accepted by the party to whom it was communicated.

Genuine Agreement. The agreement (offer and acceptance) must not be based on one party deceiving another, on an important mistake, or on the use of unfair pressure exerted to obtain the offer or acceptance.

Legality. What the parties agree to must be legal. So an agreement to commit a crime or tort cannot be a contract.

Consideration. The agreement must involve both sides receiving something of legal value as a result of the transaction.

Capacity. To have a completely enforceable agreement, the parties must be able to contract for themselves rather than being obligated to use parents or legal representatives.

In addition, some agreements must be placed in writing to be fully enforceable in court.

Contracts frequently result from the exchange of valuable promises. For example, a couple may want their home painted. Suppose a painter measures the exterior of their house and promises to paint the house within 30 days for \$3,000. This is the offer. If the couple agrees to the time frame and the \$3,000, this is the acceptance.

The painter is the offeror. He communicated a serious, definite proposal to the couple. The couple are offerees (persons to whom the offer is made). Without both offer and acceptance on mutually agreed terms, there is no contract. No particular language need be used. In What's Your Verdict? Pedro and Seamus made a contract, even though delivery and payment will occur later.

Requirements of An Offer

What's Your Verdict? Anchors Aweigh, a boat retailer, placed an ad in a local newspaper announcing a one-day sale of cabin cruisers for the "bargain price" of \$22,500 each. The dealer had five cruisers in stock, and they all were sold within one hour. During the rest of the day, seven other would-be buyers came in to purchase a bargain cruiser. Did the Anchors Aweigh advertisement make offers to the would-be buyers?

An **offer** is a proposal by an offeror to do something, provided the offeree does something in return. If the offeree accepts the proposal, a contract arises. Generally, to create a valid offer:

- the offeror must appear to intend to create a legal obligation;
- the terms must be definite and complete; and
- the offer must be communicated to the offeree.

Expression of Intent to Create a Legal Obligation

The law will only recognize that an offer exists when the offeror appears serious about creating a legal obligation.

Test of the Reasonable Person. The law is not concerned with what is actually in the mind of a person making a purported offer. Rather, it is concerned with the appearance of this person. So if you think you are joking, but a reasonable person would interpret your conduct as indicating that you intend to contract, you have made an offer. On the other hand if you are serious, but a reasonable person would interpret your conduct as a joke, then no offer is made. This is called the **test of the reasonable person**. It is an objective legal test used by jurors or judges rather than a subjective test based on what you say you were thinking. Businesses and the law need a consistent way to determine when an offer is made. A subjective test would let people escape contractual responsibilities by lying about what they were thinking.

Facts and Circumstances. The test of the reasonable person examines the offeror's words and conduct in light of all the relevant facts and circumstances. The words themselves may indicate an offer, but a reasonable person would disregard them because of the facts and circumstances under which they were spoken. When a teacher says to a business law class, "I offer to sell you my new car for \$3,000," this probably isn't an offer but an example. Words spoken in obvious jest, frenzied terror, or anger would not be offers if a reasonable listener would realize that no offer was intended.

Preliminary Negotiations. Information is often communicated without indicating an intent to contract. So, you might casually say, "Would you take \$800 for that laptop computer?" You are probably trying to determine whether the other party is interested in selling and the ballpark price. This contrasts with an offer which might take the form, "Look Jeff, I'll give you \$800 today for your laptop computer. Do you agree to my deal?" Sometimes one party states tentative terms, inviting others to make offers. If Jeff says, "I think I'm interested in selling my laptop computer for around \$1,000. Is anybody interested?" this is not an offer to sell.

Social Agreements. If two friends agree to go to the movies, no contract is intended. The friends don't think of this agreement as creating legal obligations. If either breaks the date, the other may be offended but cannot win a suit for breach of contract. Social arrangements do not create legal obligations.

Offer Must Be Complete & Clear

The terms of an offer must be sufficiently complete and clear to allow a court to determine what the parties intended and identify the parties' legal rights and duties.

Complete and Clear. If a supposed offer is missing essential information, it is incomplete and legally ineffective. Nearly all offers must identify the price, subject matter, and quantity, either directly or indirectly. The amount of information which is essential depends upon the complexity of the transaction. In addition, each essential term must be identified clearly. If terms are not identified clearly or definitely enough for courts to enforce an agreement, then the offer is invalid.

Implied Terms. In some contracts, a term might be implied by law or common business practice. For example, in contracts between merchants for the sale of goods, when the price is not specified, current market price is the basis for the contract.

Advertisements. Advertisements in newspapers and magazines, on radio or television, or in direct mailings are generally not offers. Instead, courts treat them as invitations to customers to make offers. This is primarily because a person who advertises something for sale has a limited stock and cannot be expected to sell to the many thousands who theoretically might reply to the advertisement. In *What's Your Verdict?* Anchors Aweigh advertised boats. When would-be buyers tendered the purchase price of the cabin cruiser, the would-be buyers were the ones making an offer. Thus, Anchors Aweigh was not bound by contract to the seven would-be buyers who came to purchase the boats after they were out of stock. To promote good customer relations, businesses try to deliver advertised merchandise to all who want to buy. Statutes prohibit false or misleading advertising.

Offer Must Be Communicated

A person who is not the intended offeree cannot accept the offer. Nor can a person accept an offer without knowing it has been made. That is because any action taken would not have been a response to the offer. Thus, an offer of a reward that is made to certain persons or even to the general public cannot be accepted by someone who has never seen or heard of the offer. In such cases, the offeror may get what was sought, but most courts require that anyone who claims the reward must have known of the offer and acted in response to it when performing the requested act.

Think Critically About Evidence

1. The owner of a small color television set offers to sell it to a neighbor for \$75. As the neighbor stands there thinking about the offer, a bystander says, "That's a bargain. I'll take it!" Is there a contract between the bystander and the owner?
2. Bill spent most of his month's allowance for expensive tickets to a rock concert after Lorene said she would go with him. On the morning of the event, Lorene phoned and said she was terribly sorry, but Tony, the high school's star fullback, had also asked her to go and she "just couldn't say no." Did she breach a contract? Could Tony be held legally liable if he knew Lorene had already promised to go with Bill? Was Lorene's conduct ethical? If Tony knew Lorene had already promised Bill she'd go with him, was Tony's conduct ethical?
3. The Nationwide Credit Union agreed to allow Heidi to borrow up to \$10,000. Nothing was specified as to the length of the agreement, the rate of interest the credit union would charge, or the terms of repaying any loan. The credit union did not make a loan of \$8,000 to Heidi when she requested it four years later. Is the credit union liable for breach of contract?
4. G. Whiz Sports Shop published this advertisement in the local newspaper: "Congratulations to the winners of the Tour de France! Now YOU TOO can be a champ! Get an 18-speed Blue Lightning bicycle for only \$1,295—marked down from \$1,795, the manufacturer's suggested retail price. What a bargain! Come and get it!" Baxter visited the discount store the following day and said, "I'll take one of the Blue Lightning bikes." The clerk replied, "Sorry, we had only ten bikes in stock and they've all been sold." Was the advertisement an offer?

2-2 Offer & Acceptance: Termination of Offers**How Can Offers Be Ended?**

What's Your Verdict? Melissa offered her collection of baseball cards for sale for \$3,000 to her friend and fellow collector, Raoul. Raoul asked if he could think it over and Melissa agreed. While Raoul was trying to raise the money, Melissa had second thoughts. So she called Raoul and said, "I've changed my mind, I'm not interested in selling the cards." Raoul responded, "It's too late, you promised to sell them to me, and I've got the money so I accept." Was Melissa's offer terminated before Raoul tried to accept?

Once made, an offer does not last forever. There are several ways to **terminate** offers.

Revocation by the Offeror. After an offer has been made, the offeror can generally revoke it anytime before it is accepted by the offeree. In *What's Your Verdict?* because Melissa revoked first, there was no offer alive when Raoul tried to accept. Therefore there was no contract. This is true even if the offeror promised that the offer would remain open for a particular period. The right to withdraw an offer before it is accepted is known as the right of **revocation**. A revocation is not effective until communicated to the offeree.

Time Stated in the Offer. In making an offer, the offeror may state how and when the offer must be accepted. For example, on October 10, the Mercantile Bank sent a letter to Boggs, who had applied for a loan. In the letter, Mercantile offered to lend \$50,000 on specified terms and stated that the acceptance had to be received no later than October 18. Boggs mailed an acceptance on October 17, but the letter did not arrive until October 20. Mercantile did not receive Boggs' reply by the time specified. Therefore the offer evaporated and there was no contract.

Reasonable Length of Time. When nothing is said in the offer about the length of its life, it is alive for a reasonable length of time. What is a reasonable length of time depends on all the surrounding circumstances. For example, a produce broker in Ohio called a customer in Florida offering to sell a truckload of tomatoes. If the offer to sell the tomatoes was not accepted within an hour, it probably would terminate automatically. That is because tomatoes are perishable produce which rot and therefore must be shipped quickly. In contrast, an offer to sell expensive durable equipment, such as a truck and trailer, would not terminate until a longer time had elapsed. At least several days would probably be reasonable.

Rejection by the Offeree. When an offeree clearly rejects the offer, the offer is terminated. For example, Kempisky offered to sell Del Rey a bicycle for \$75, but Del Rey replied, "No, too much." The next day, Del Rey called Kempisky and said, "I've changed my mind. I'll take your bike for \$75." However, Del Rey's earlier refusal was a rejection, which ended the offer. An offer is terminated by an offeree's rejection even if a time limit set by the offeror has not expired.

Counteroffer. Generally an offeree accepting an offer must accept it exactly as made. If the offeree changes the offeror's terms in important ways, a **counteroffer** results. In making a counteroffer, the offeree says in legal effect, I refuse your offer; here is my proposal. The counteroffer terminates the original offer. Then the counteroffer becomes a new offer. Unless renewed by the original offeror, the original offer can no longer be accepted by the offeree.

Death or Insanity of Either Party. Contracts are agreements voluntarily entered into by the parties and subject to their control. Death or insanity eliminates such control. Therefore the law acts for these parties when they can no longer act and terminates their offers.

How Can An Offer Be Kept Open?

What's Your Verdict? The Downings had placed their factory building on the market for \$950,000. Robinson, a developer, was interested in buying it, but she needed time to persuade a group of investors to join her in purchasing the building. Robinson offered \$10,000 to the Downings to keep the offer open to her alone for 60 days. The Downings accepted the money. Are they now legally bound to keep the offer open to Robinson?

Generally, an offeror is not obliged to keep an offer open for a specified time even if the offeror has promised to do so. Why? Because the offeree has given nothing in exchange for the promise.

Options. If the offeree gives the offeror something of value in return for a promise to keep the offer open, this agreement is itself a binding contract. It is called an **option**. The offer may not be withdrawn during the period of the option. In *What's Your Verdict?* Robinson held an option to buy the factory building. Thus, the Downings could not legally withdraw the offer. If they sold to a third party (who was unaware of the option) during the 60-day period, the Downings would be liable to Robinson for damages. Generally, the original offeror keeps the payment received for the option even if the offeree decides not to exercise the right to buy. Usually, if the original offer is accepted within the span of time allowed, money paid for the option is applied to the purchase price. However, this must be agreed to in advance.

Firm Offers. A special rule applies to merchants (those who regularly deal in the goods bought or sold). An offer by a merchant for the sale or purchase of goods stating in a signed writing how long it is to stay open is called a **firm offer**. Firm offers are binding for the time stated (but not more than three months). This is true even when nothing is paid by the offeree. Generally, neither death nor insanity of either party terminates an option contract or a firm offer.

Think Critically About Evidence

1. While at Prescott's garage sale; Wood noticed a large, metal tool chest in the corner, complete with about 400 standard and metric tools. Wood offered to buy it for \$1,250 and said, "You can take a week to think about it before you decide whether to accept." Four days later, and before Prescott had responded, Wood told Prescott that he had found another set for less money and withdrew his offer. Can Wood withdraw his offer?
2. Frank saw a motorized wheelchair advertised in the paper. When he called, it was described to him and he drove out to see it. The seller was asking \$900 for it, but it needed work. So Frank offered \$700. The seller said she wasn't interested at that price. Later, Frank called and accepted the offer at the \$900 price. However, the seller said it had been sold. Frank became upset and sued. Will the seller be liable? Why or why not?
3. Gus walked into his local hardware store to buy exterior paint for his house. It was on sale for \$35 a gallon: Gus wanted to check around but didn't want to lose the chance to buy at the sale price. In response to Gus's request, the manager of the paint department wrote Gus a note stating, "Gus Almondson may buy up to 15 gallons of Old Dutch Exterior Grade paint for \$35 per gallon anytime within the next two weeks." The manager signed and dated the note. Is this offer binding?
4. Phil was talking with Sharon about Opie, his Springer Spaniel dog. Phil explained that Opie has a strong personality, loves to snuggle up to people, likes to eat "people food," and is a good watchdog. Sharon liked Opie a lot and needed a dog. She asked Phil how much he paid for Opie. Phil said, "I paid \$75, but I wouldn't sell Opie for ten times that amount. Sara said, "Well okay, it's a deal then. I'll give you \$800, more than ten times the \$75." Has Opie, been sold?

2-3 Offer & Acceptance: Acceptances

How Are Acceptances Created?

What's Your Verdict? Darrow offered to trade his digital camera to Monette in exchange for her camcorder. Schorling, who had a camcorder of the same make and model, overheard the offer and said she would make the swap. Did a contract result from Schorling's statement?

Acceptance occurs when a party to whom an offer has been made agrees to the proposal. To create an enforceable contract, the acceptance must:

- be made by the person or persons to whom the offer was made;
- match the terms in the offer; and
- be communicated to the offeror.

Who Can Accept An Offer?

An offer made to one person cannot be accepted by another. Accordingly, no contract resulted in What's Your Verdict? Only Monette, not Schorling, could have accepted Darrow's offer. Sometimes, however, an offer is made to a particular group or to the public and not to an individual. For example, a reward offer may be made to the general public. Any member of the general public who knows of the offer may accept it by doing whatever the offer requires.

Acceptance Must Match Offer

The offeror may specify the terms of the acceptance, such as when and how the acceptance must be made. To complete the agreement, the offeree must then comply with such terms. Any change by the offeree in such required terms of the offer ends the original offer and results in a counteroffer. This is so even if the change is advantageous to the original offeror.

Mirror Image Rule. The **mirror image rule** requires that the terms in the acceptance must exactly match the terms contained in the offer. If it varies any term, it is a counteroffer. This law applies to contracts for services (such as tax preparation) and realty (such as the sale of a home). Courts in some states apply this rule only when the term in the offer is material (important). By statute, the mirror image rule has been changed in contracts for the sale of goods (such as books, computers, clothing, and food).

Acceptance Must Be Communicated to the Offeror

An acceptance must be more than a mental decision. It must be communicated to the offeror.

Silence as Acceptance. One is not obliged to reply to offers made by others. An offeror's attempt to word the offer so that silence would appear to be an acceptance will not work. Sometimes, in a continuing relationship, the parties may agree in advance that silence is to be regarded as acceptance. For example, in a monthly book club, it may be agreed that failure to say "no" to a proposed shipment is to be regarded as "yes." Or a food market may have a standing order to have a wholesaler ship a certain amount of produce every day unless the retailer breaks the silence with some notice. Only in situations such as these, where the parties have agreed in advance, can silence be acceptance.

Unilateral Acceptance. In some offers, the offeror requires that the offeree indicate acceptance by performing his or her obligations under the contract. Contracts offered under these conditions are **unilateral contracts**. The offeror in a unilateral contract promises something in return for the offeree's performance and indicates that this performance is the way acceptance is to be made. For example, the offeror may publicly promise to pay a \$100 reward to anyone who returns a lost dog. Many people learn of the offer. All may join the search. A promise to look for the dog does not create a contract. Only one person may find and return the dog, thus performing the act required to accept the offer and earn the reward. When the offeree has begun performance of the act requested, the offer cannot be revoked until the offeree has had a reasonable amount of time to complete performance.

Bilateral Acceptance. Most offers are bilateral. This means the offer implies that it can be accepted by giving a promise instead of performing the contracted-for act. For example, a seller promises to deliver a load of topsoil in exchange for a homeowner's promise to pay \$65. Offers for **bilateral contracts** require that the offeree accept by communicating the requested promise to the offeror. Until this is done, there is no contract. The promise can be implied from the offeree's conduct as well as from words.

When Acceptance Is Effective.

Contractual communications such as offers, acceptance, rejections, revocations, and counteroffers may be communicated orally, in person, or by telephone. They also may be communicated in writing and sent by mail, delivery service, e-mail, or fax machine. When the communication takes time, for example when sent through the surface mail, the question of when the communication is effective is very important. All forms of contractual communications but one take effect only when received. The exception to this is the acceptance, which is often effective when sent.

The offeror may require the offeree to use a certain communication method. If a different method is used, then it is treated as a modification of the offer. Business custom often implies a method to be used in an acceptance. Most courts then say the acceptance is effective when sent by the same means used for the offer, or by faster means.

Think Critically About Evidence

1. Schneider offered to sell his motor home to Nunzio for \$28,000. Schneider specified that in accepting, Nunzio must agree to pay the entire amount within 30 days. Nunzio accepted but changed the terms to \$8,000 down and the balance in 20 equal payments with interest at 10 percent a year on the unpaid balance. Was there an acceptance?
2. Jonas wrote to Smith offering to sell 42 acres of farmland at \$5,000 per acre with the purchase price to be paid at the closing. Smith replied, "I accept for the 42 acres, for the \$5,000 per acre, but will pay the purchase price two days after closing." Is this an acceptance?
3. Office Suppliers, Inc., ordered 2,000 reams of 20 lb. paper from Dimension Paper for \$1.75 per ream to be delivered at the Office Suppliers warehouse on April 24. Dimension responded that 2,000 reams would be delivered on April 25 at the price of \$1.75 per ream. Office Suppliers made no further response. Has a valid contract been formed? If so, what are the terms? If not, why not?
4. On October 12, Gary sent by first-class mail an offer to sell his computer to Wanda. On October 14, Wanda received the offer. She thought about the offer and sent an acceptance by first-class mail on October 18. Gary received the acceptance on October 20. However, Gary had changed his mind about the price he wanted for the computer, and he had sent Wanda a revocation of his offer on October 16. Wanda received the revocation on October 19. Was a contract formed? If so, on what date? If not, why not? "
5. Don wanted to buy an Audi Quattro. He sent by first-class mail a letter to three Audi dealers and a new car broker. The letter contained a description of the car, the price he would pay, and the delivery date. He indicated he would pay cash within five days after the acceptance. Don also specified that any acceptance would be effective only when received. A local Audi dealer and the new car broker accepted by letters arriving on the same day. Does Don have two contracts to purchase?
6. Caryn offered to tutor Dottie in business law for six hours on the day before the final exam in return for \$100. Dottie responded, "Let me think about it for a day, okay?" Two hours later Jim offered Caryn \$150 to tutor him on the day before the final and she accepted. Dottie called Caryn an hour later and said, "I accept." Caryn said, "I'm sorry but I've already agreed to tutor Jim that day so I can't tutor you." Was there a contract between Caryn and Dottie?
7. Sam advertised his ski boat for sale, priced at \$4,500, complete with outboard engine and trailer. Barbara paid Sam \$100 for a ten-day option, the money to be applied to the purchase price if she exercised her right to buy. Two days later, Sam was killed. Is Barbara's option still valid?

2-4 Genuine Agreement: Duress and Undue Influence

Hot Debate: Your friend buys a digital camera for \$519.97, including a carrying case and a special lens. In her excitement, she fails to notice that the case and special lens are advertised as optional equipment supplied at an additional charge. The two items cost an extra \$122.94, which is listed on the contract she signs. When the bill for \$642.91 plus sales tax arrives, your friend objects. State 3 reasons why it would be fair to allow your friend to withdraw from the contract. State 3 reasons why it would be fair for your friend to be bound contract. Which reasons are more persuasive?

Genuine Agreement and Rescission

What's Your Verdict? Cameron, owned a promising racehorse that Link had offered to buy for undisclosed parties. When Cameron refused to sell, Link lowered his voice and slowly said, "Listen, the people I represent don't take 'no' for an answer. If you don't sell, they'll hurt you. They'll hurt your family. Like a good friend, I'm telling you to sell. You're getting a fair price, just sign the contract." Cameron, who had secretly recorded the conversation, sold. Then he called the police. Can he now rescind and get his horse back?

Papers or documents may indicate a valid offer and a valid acceptance. However, if one of the parties used physical threats to obtain the other's signature on a contract, there isn't really genuine agreement. **Genuine agreement** (also called genuine assent or mutual assent) may be lacking due to duress, undue influence, mistake, misrepresentation, or fraud. The absence of genuine agreement will make what appears to be a contract voidable. This means the injured party can rescind. **Rescission** is backing out of the transaction by asking for the return of what you gave in the transaction, and offering to give back what you have received. To be effective, a rescission must be prompt. It must occur shortly after you discover that there is no genuine agreement. In addition, it must occur before you ratify the contract. **Ratification** is conduct suggesting you intend to be bound by the contract.

In This Case: Steven inspected a 5-year-old car with the intention of buying it. He asked the owner, Allan, how many miles were on the engine. Allan said, "As you can see from the odometer, it only has 30,000 miles on it, and I'm the only one who has ever owned it." A written contract was executed and Steven took the car to the local auto dealer to be inspected. The dealer informed Steven that the car had often been services there, and that the odometer had been replaced at about 100,000 miles. This was fraud on Allan's part, making the contract voidable by Steven. But if Steven continued to make his monthly payments to Allan after discovering the fraud, this would ratify the contract and Steven would lose his ability to rescind.

Duress

Duress occurs when one party uses an improper threat or act to obtain an expression of agreement. The resulting contract is voidable. Much of the law of duress focuses on the nature of the threat.

Threats of Illegal Conduct. The threat to engage in illegal conduct, such as a crime or tort, to win agreement is always duress. Committing an act of violence (for example, stabbing), threatening a crime (threatening to stab), committing a tort (for example, unlawful detention), or threatening a tort to obtain a signature on a written contract is duress. The actual crime or tort, or the threat, may be to the physical life, liberty, or property of the victim, the victim's immediate family, or the victim's near relatives. In *What's Your Verdict?* Cameron acted under duress in making the contract and therefore could rescind it.

Threats to Report Crimes. If you observe a crime, you have a duty to report it to the proper authorities. If you use a threat of reporting to coerce the criminal to contract with you, this is duress. It may also be the crime of extortion.

Threats to Sue. The law encourages parties to settle conflicts without a suit. An important part of this process involves communicating a threat that you will sue if the other side doesn't settle. This happens frequently. But when the threat to sue is really made for a purpose unrelated to the suit this may be duress. For example, during divorce negotiations, a husband threatens to sue for custody of the children if the wife doesn't sign over valuable shares of stock. Because he doesn't really want custody of the children, this threat to sue makes the contract for the stock voidable. If the threatened suit is completely groundless, a resulting contract may be voidable for duress.

Economic Threats. Often when parties are bound by a valid contract, they will seek to modify it. Parties then are tempted to use the economic power they have over one another to negotiate a favorable modification or settlement. If a manufacturer has a contract to pay a supplier \$15 for a special computer part needed to maintain production, the supplier might threaten to withhold the parts unless the manufacturer agrees to a price of \$20 each. If a disruption in the flow of parts would cause substantial injury to the manufacturer, then the courts would find the agreement on the new price an economic threat voidable for duress. In economic duress cases, the courts look at both the threat and the alternatives available to the threatened party. If the threatened party had no choice but to enter into or modify a contract, then duress exists.

In This Case: Snap-On manufactures and sells hand tools such as wrenches to professional mechanics. It sold a distributorship to Eulich, but he was not successful and encountered significant financial difficulties. In Eulich's view, his sales territory was too small. As a result Eulich terminated the dealership agreement. That agreement included a clause stating that on termination of the agreement, Snap-On might buy back any new tools owned by the distributor. Eulich attempted to turn in his tools but Snap-On delayed. Eulich's financial situation deteriorated to the point where he was unable to pay his personal bills and his wife needed to be hospitalized, though he had no medical insurance. Snap-On knew this. Finally, Snap-On accepted the tools. Before paying for the tools, Snap-On asked Eulich to sign an agreement promising not to sue Snap-On for claims arising out of the distributorship. He signed but later sued. The court looked at both the economic threat (not to buy back the tools) and Eulich's alternative (no money for wife's medical treatment) and found the agreement not to sue was based on duress.

Undue Influence

What's Your Verdict? Smith was in the hospital near death. His nurse said she would not give him drugs for pain unless he signed a contract transferring certain stock to her for half its market value. Smith signed. Is Smith bound?

Undue influence occurs when one party to the contract is in a position of trust and wrongfully dominates the other party. The dominated person then does not exercise free will in accepting unfavorable terms. The two key elements in undue influence are the relationship and the wrongful or unfair persuasion. When a contract arises because of undue influence, the contract is voidable by the victim. In *What's Your Verdict?* the contract transferring Smith's stock is voidable by Smith.

The Relationship. A relationship of trust, confidence, or authority must exist between the parties to the contract. This relationship is presumed to exist between an attorney and client, wife and husband, parent and child, guardian and ward, physician and patient, or minister and congregation member. But a formal relationship is not necessary. So a relationship of trust could arise between a housekeeper and her elderly employer. It could also arise between a handicapped person and his neighbor.

Unfair Persuasion. Often the best evidence of unfair persuasion is found in unfair terms of the contract. For example, an elderly person, who is dependent on one child for daily care, may sell her home to that child for half its value. This is strong evidence of lack of free will. A charge of undue influence can be overcome by proving that the contract is fair to both parties.

To prevent a claim of undue influence, the stronger party should act with scrupulous honesty, fully disclose all important facts, and insist that the weaker party obtain independent counsel before contracting. Persuasion or nagging do not necessarily mean undue influence exists. Whether action rises to the level of undue influence is a difficult question of fact for a jury.

Think Critically About Evidence

1. Mary rented an apartment and later discovered that the roof leaked. She asked the landlord to make repairs, but he refused. Mary said that she would move out unless the landlord either made the repairs or lowered the rent. The landlord lowered the rent. Is Mary's conduct a form of duress?
2. Michelle rented an apartment and later discovered several housing code violations. She asked the landlord to make repairs, but he refused. Michelle said that she would inform the housing authorities unless the landlord either made the repairs or lowered the rent. The landlord lowered the rent. Is Michelle's conduct a form of duress?
3. Ted owned a thoroughbred racehorse that had been on a winning streak. Gifford wanted to buy Ted's horse. To induce Ted to sell, Gifford offered Ted twice the value of the horse. Ted accepted. Later Ted changed his mind and sought to rescind claiming economic duress. Will Ted prevail?
4. Evelyn was 86 years old and of sound mind. However, she relied upon her nephew Jerry, an accountant, to advise her in business matters. Jerry visited Evelyn often. During one of his visits, he persuaded her to sell him a valuable painting for about 80 percent of its true value. Evelyn agreed and signed a contract. Then she had the painting appraised and learned its true value. She continued with the transaction by accepting payment for the painting. About a year later she died. Her estate sued for rescission of the contract. Jerry defended by claiming that Evelyn had ratified by accepting payment after learning of the value of the painting. Who prevails, Evelyn's estate or Jerry?

2-5 Genuine Agreement: Mistake, Misrepresentation, and Fraud**Unilateral Mistake**

What's Your Verdict? Baglio wanted the gutters of his new house to be free of rust. The specifications in the contract he signed called for "rust-resistant steel gutters galvanized with zinc." After the house was built, he learned that galvanized steel gutters would eventually rust and require replacement. Aluminum or copper gutters are the kind he should have contracted for because they would not rust. Baglio now sues the contractor claiming a breach of contract because he did not get what he really wanted. Will he win?

A **unilateral mistake** occurs when one party holds an incorrect belief about the facts related to a contract. Generally, this does not affect the validity of the contract. In *What's Your Verdict? Baglio* alone was mistaken, so he will lose the lawsuit. A mistake from failure to read a contract before signing is a unilateral mistake. So is a misunderstanding from a hurried or careless reading. Similarly, signing a contract written in language you don't understand will bind you even if you are mistaken about some of the contract's content.

Recognized Unilateral Mistake. If the unilateral mistake is a major one, and the other party to the contract is aware of the mistake, a court may grant rescission to the injured party.

Induced Unilateral Mistake. If one party has encouraged or induced the other to make the mistake, the contract is voidable. Assume you were looking at a tray of diamonds in a jewelry store. You chose the only stone on the tray that was a zirconium and offered a high price for it. The mistake would have been induced by the mixing of the zirconium with many real diamonds. Therefore, the contract would be voidable.

In This Case: Genetic Products Inc., asked for bids (offers to build) for its new office building. Eight bids were received. Seven of within \$100,000 of the architect's estimate of \$3 million. However, the bid from New Horizon Builders was \$800,000 below the architect's estimate. Horizon's chief estimator made a math error. This error reduced New Horizon's bid far below those of other competitors. Genetic Products recognized this. Therefore, it may not seize upon New Horizon's unilateral mistake and demand bargain price created by the mistake.

Bilateral (or Mutual) Mistake

What's Your Verdict? In a large Midwestern city, there were two streets named "Highland." Fisher owned the lot at 231 Highland Avenue. Neece, who lived in New York City, wanted to buy the lot at 231 Highland Boulevard. He wrote to Fisher, offering "to buy your lot on Highland" on specified terms. Fisher promptly mailed her acceptance of the offer. Is the contract valid?

Bilateral Mistake. When there is a **bilateral mistake** (also called a mutual mistake) both parties have an incorrect belief about an important fact. Important facts that influence the parties' decisions about a contract are called material facts. If a mutual mistake occurs, the contract is void. If both a buyer and seller think that property is 41 acres and they contract for the sale based on this belief, then learn later that it is only 28 acres, this is a mutual mistake of fact. Their agreement is not binding.

Mistake about the Subject Matter. Mutual mistakes may occur as to the existence of the subject matter, as shown in the following example. The law treats a unilateral mistake about the identity of the subject matter of a transaction as a mutual mistake. Thus, in *What's Your Verdict?* the buyer's mistake as to the identity of the subject matter made the contract void. Neece, in his offer, was referring to the lot on Highland Boulevard. Fisher, in her acceptance, was referring to the lot on Highland Avenue. There was no genuine agreement between the parties.

Mistake of Law. In most states, when the mutual mistake is about the applicable law, the contract is still valid. For example, if both parties to a sale of land mistakenly believe that local zoning laws permit construction of duplexes on the lot, the contract would be valid though there was a mutual mistake. This is because all persons are presumed to know the law.

In This Case: Falkhausen, who lived in Indianapolis, owned a Formula One racing car that he kept in Miami. On March 18, he sold the car to Firenzi. The car had been destroyed in an accident on March 17 when the garage in which the car was stored burned to the ground. Neither Falkhausen nor Firenzi knew about the fire. Because of the mutual mistake as to the existence of the car, there was no contract.

Misrepresentation

What's Your Verdict? Nutri-Life offered a dietary supplement for sale. The package contained a statement that clinical studies at Harvard University had shown the drug reduced the risk of cancer by more than 30% if taken regularly. This statement was untrue. Can customers get their money back if they learn of the deception?

In many contract negotiations, the parties make statements that turn out to be untrue. For example, in the sale of a car, the seller might say that it has 70,000 miles on it when in fact it has 150,000 miles on it. If the seller didn't know the true mileage because a prior owner replaced the odometer, this is an innocent misrepresentation. If the seller had known the statement were untrue, the seller would have engaged in fraudulent misrepresentation.

Both of these defenses make the contract voidable. Statements are treated as **misrepresentation** only if:

- the untrue statement is one of fact or there is active concealment, and
- the statement is material to the transaction or is fraudulent, and
- the victim reasonably relied on the statement.

Untrue Statement. In misrepresentation, the statement must be one of fact rather than opinion. Therefore the statement must be about a past or existing fact. If someone says, "This car will suit your needs well for at least the next year," this is a statement about the future and therefore must be an opinion. It cannot be the basis for misrepresentation. A seller's statement that, "I'm sure land values will increase at least 15 percent a year for the next three years," is a statement of opinion.

Opinions also can be distinguished from facts based on how concrete they are. Saying, "it really runs well," is a statement of opinion about the condition of the car. Statements like "This is the best tasting cola on the market" are mere sales talk. In contrast, if the seller said, "the engine was rebuilt 7,000 miles ago," this is the expression of a concrete fact. It is a misrepresentation if untrue.

When experts express an opinion, the law will treat the statement as a statement of fact. But this also can be the basis for misrepresentation. If an expert auto mechanic says, "The engine is in A-1 shape," and this is not true, it is a misrepresentation and the buyer could rescind. The packaging of the Nutri-Life dietary supplement in *What's Your Verdict?* involved an expert's opinion that constituted misrepresentation.

Active Concealment. Active concealment is a substitute for a false statement of fact. If the seller of a house paints the ceiling to cover stains which indicate the roof leaks, this is active concealment. Similarly, if a seller places the price sticker on the TV screen to cover a wide scratch, this is active concealment.

Silence. While in many situations the seller may remain silent about defects, there are three important situations where disclosure is required. The first is where a statement about a material fact omits important information. If a seller says, “I only drove this car once a week,” then the seller must also disclose that this occurred while racing the car at the local drag strip. Half-truths cannot be used to conceal or mislead. The second duty to break silence arises when a true statement is made false by subsequent events. A seller says, “No the roof doesn’t leak.” Later that night, it begins leaking and the seller ends up sleeping under an umbrella. This seller must break silence and disclose the defect to correct the buyer’s misimpression. The third situation arises when one party knows the other party has made a basic mistaken assumption. For example a buyer may assume that a foundation is solid, but the seller knows of a defect allowing water to flood the basement each spring. The seller knows repairs will cost 25 percent of the sale price. This mistaken assumption must be corrected.

Materiality. There are three ways an untrue statement can be determined to be material. First, a statement is material if the statement would cause a reasonable person to contract. Statements about total miles on a car and the number of miles since an engine was rebuilt would probably cause a reasonable person to complete the contract. A statement that a star’s signature on a baseball card is his authentic autograph, when in fact it is a forgery, is a statement that would be material to a reasonable person. Second, a statement can be material if the defendant knew this plaintiff would rely on the statement. Suppose a seller says the oil in the car was changed every 3,000 miles when it was only changed every 4,000 miles. This slight discrepancy would probably not be material to a reasonable person. If, however, a buyer says that the frequency of oil changes is very important to her, then statements about the frequency of oil changes would be material. Third, if the defendant knew the statement was false, this makes the statement material. Therefore, if a seller lies about an otherwise nonmaterial fact, this is material. So if a seller says, “I always had the car serviced at the local Chevrolet dealership,” when in fact he had it serviced at the local gas station, this statement would be material.

Reasonable Reliance. Even though the statement is material, there is no misrepresentation unless the victim reasonably relied on it. A buyer may be told by a diamond expert that the stone is perfect, but then learns from an appraiser that it is not. If the buyer still completes the sale, the buyer isn’t relying upon the statement. If a car dealer says the tires are new, but the buyer responds, “Two are as bald as you,” there is no reliance.

Fraud

What’s Your Verdict? Grafter sold a used car to Camacho for \$16,000. Grafter told her that the car had been driven only 50,000 miles, had never been in an accident, and had the original paint. In fact, Grafter had stolen the car, set back the odometer from 90,000 miles, and repainted the exterior in the original color. Grafter stood between Camacho and the right rear end of the car to prevent her from seeing a crudely repaired fender that had been damaged in an accident. Later Camacho learned the truth. Can Camacho rescind?

Fraud is based on misrepresentation. All the elements of misrepresentation must be proven or there is no fraud. In addition to misrepresentation, two additional elements must be proven to show fraud: intent and injury. If a victim can show fraud, courts will grant the victim assistance beyond rescission. In *What’s Your Verdict?* Grafter was a criminal who intentionally lied about the car and actively concealed the damaged rear fender. The deception injured Camacho because the car was not worth \$16,000. Accordingly, Camacho could establish fraud.

Misrepresentation Must Be Intentional or Reckless. Fraud clearly exists when a person deliberately lies or conceals a material fact. Fraud also exists if a person recklessly makes a false statement of fact, without knowing whether it is true or false. To constitute fraud, in addition to intending to deceive, the misrepresentation must also be intended to induce the victim to contract.

Misrepresentation or Concealment Must Injure. To establish fraud, there must be proof of injury. If there is an intentional misrepresentation, but no injury, there is no liability for fraud. Suppose you are looking at an antique motorcycle. The seller says, it is a 1938 Indian. The seller knows it is a 1937 Indian but intentionally lies thinking the newer bike is more valuable. If you buy it for \$9,000 and it turns out to be worth \$14,000, you haven’t suffered an injury. While you could rescind based on misrepresentation, you could not establish fraud.

Remedies for Fraud

If a seller innocently misrepresents a material fact, the buyer may rescind. This remedy is also available for fraud. But if a victim can establish fraud, courts will also allow recovery of damages and punitive damages.

Rescission. Contracts entered into as a result of misrepresentation or fraud are voidable by the injured party. Thus, the victim (such as Camacho in What’s Your Verdict?) may rescind the agreement. Normally when you rescind, anything you received must be returned. A deceived party who has performed part of the contract may recover what has been paid or given. A deceived party who has done nothing, may cancel the contract with no further obligation. If sued on the contract, the deceived party can plead fraud or misrepresentation as a defense.

Damages. Damages are available if fraud is proven. The party defrauded may choose to ratify the agreement rather than rescind. Then either party may enforce the contract. However the defrauded party who ratified may seek damages for loss created by the fraud. So, victim could recover the difference in value for a car with 70,000 miles on it (the fraudulent misrepresentation) and one with 150,000 miles on it (the truth).

Punitive Damages. If fraud is proven, then punitive damages also become available. Punitive damages are a form of punishment. A judge might award a victim \$5,000 as a way to punish the party who committed fraud.

Think Critically About Evidence

1. Anne was shopping for a used washing machine. She found one she thought was in good condition. She asked the seller what shape it was in and the seller replied, “It is in great shape.” In fact it needed major repairs. Is the seller’s statement a misrepresentation?
2. Chip was shopping for a used computer. He found one and asked the seller if the processor was a Pentium IV. The seller said, “Yes, it is a Pentium IV processor.” In fact it was a much slower chip. Is the seller’s statement a misrepresentation?
3. Glenna found a computer she wanted. While describing all the components, the seller said it had a fast modem. Glenna said modem speed was very important to her and asked how fast it was. The seller said, “It’s a high speed modem,” but she didn’t really know how fast it was. In fact, it was a much slower modem. Has this seller committed misrepresentation? Has this seller committed fraud?
4. Audra’s aunt was more than 80 years old. Audra took care of her in the mornings. One day Audra offered her aunt \$100 for a family portrait and the aunt said, “Sure Audra, anything for you, my dear.” The portrait was only worth the one hundred dollars. Has there been undue influence?
5. In negotiations for the purchase of a ranch, Adler (the seller) discussed water rights with Folt, the buyer. Adler never mentioned an on-going dispute she had over such rights with a neighboring rancher. After the purchase, Folt realized that he had “bought a lawsuit” when his neighbor sued him over the water rights. In turn, he therefore sued Adler for rescission of their contract. Who will prevail?
6. During negotiations for the sale of a well to be used to water animals, Hutton said the well was free of gypsum and brine (salty water). In fact, the well did contain gypsum, although there was no brine. The gypsum made the well unusable for watering animals. Curry, the purchaser, refused to pay, claiming the contract was voidable because of misrepresentation. Was it?
7. Ashbery, a salesperson, told Gelman that a new computer and its accounting software should do the work of at least five employees. Relying on this statement, Gelman bought the products. When Gelman found that he could eliminate only three employees, he claimed fraud. Was fraud committed?
8. Moser had no automobile liability insurance, although it was required by state law. She negligently collided with Chang’s car. Chang threatened to sue if Moser failed to pay \$1,000 for pain and suffering and \$2,000 for car repairs. Moser gave Chang a check for \$3,000. Then she stopped payment on it, claiming duress. Was it duress?