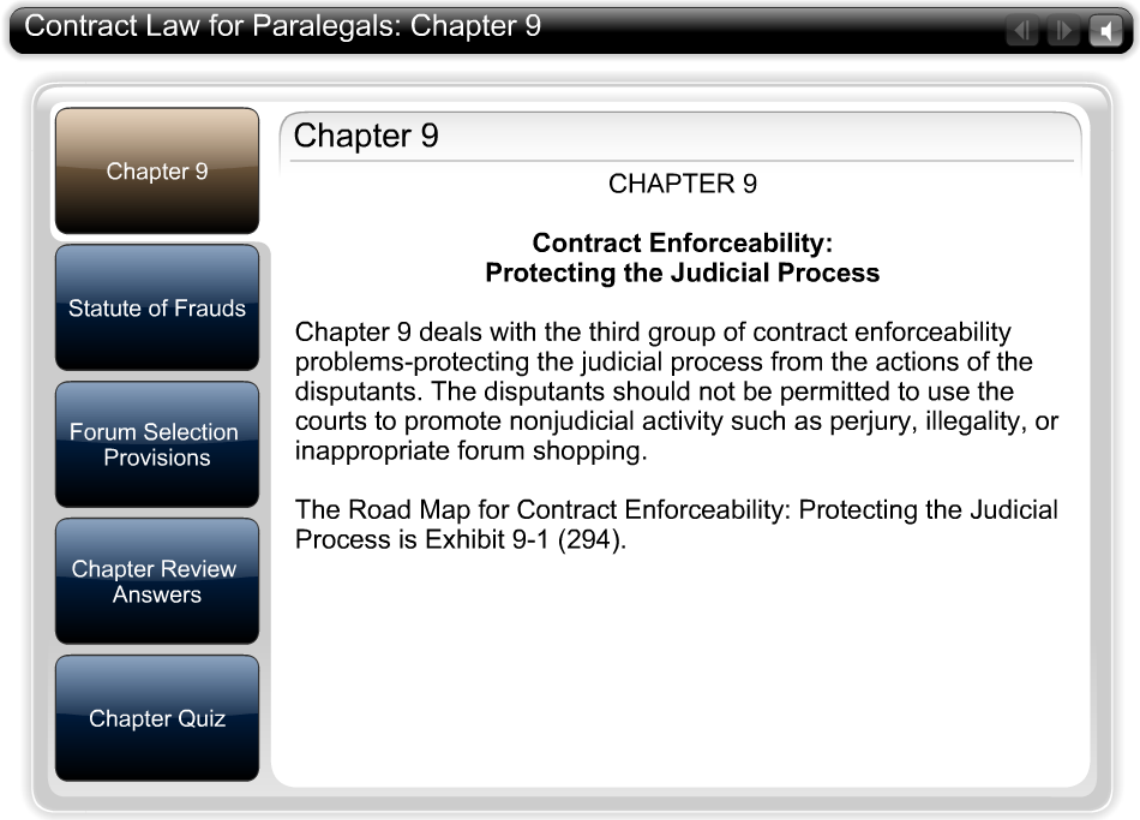
Contract Law for Paralegals: Chapter 9

Chapter 9



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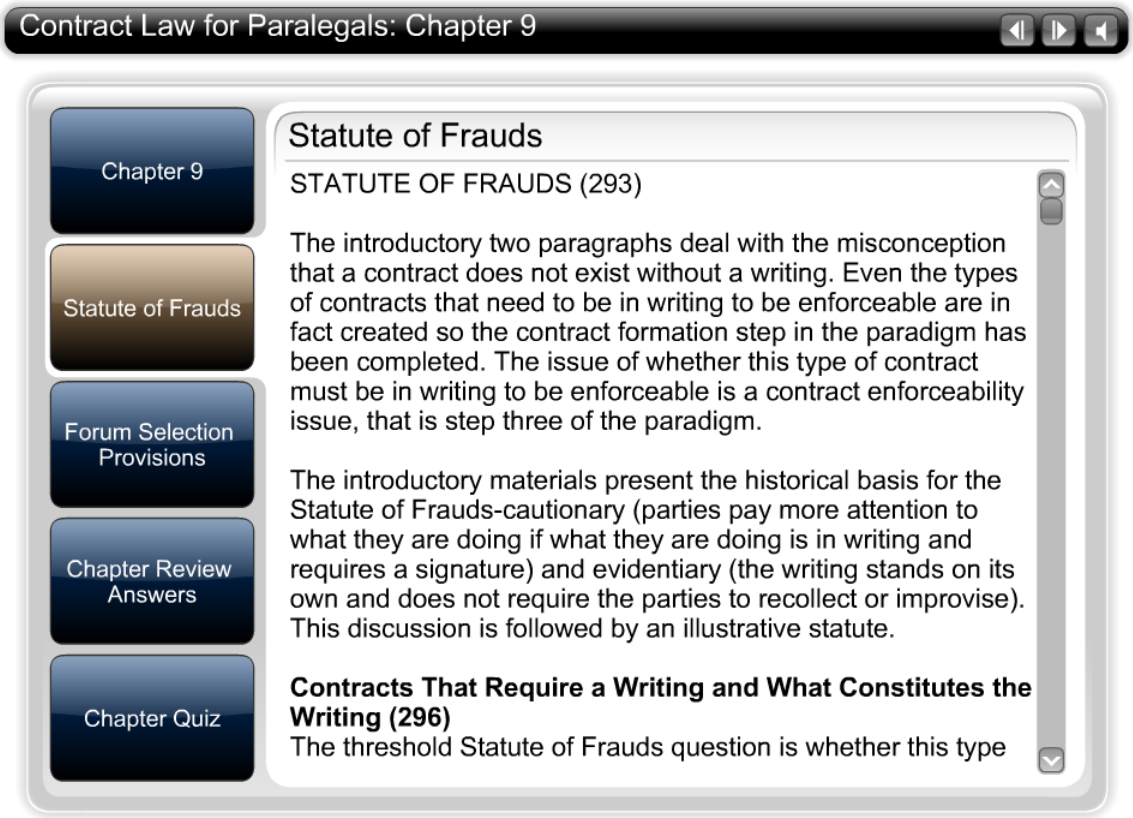
CHAPTER 9

Contract Enforceability:
Protecting the Judicial Process

Chapter 9 deals with the third group of contract enforceability problems-protecting the judicial process from the actions of the disputants. The disputants should not be permitted to use the courts to promote nonjudicial activity such as perjury, illegality, or inappropriate forum shopping.

The Road Map for Contract Enforceability: Protecting the Judicial Process is Exhibit 9-1 (294).

Statute of Frauds



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STATUTE OF FRAUDS (293)

The introductory two paragraphs deal with the misconception that a contract does not exist without a writing. Even the types of contracts that need to be in writing to be enforceable are in fact created so the contract formation step in the paradigm has been completed. The issue of whether this type of contract must be in writing to be enforceable is a contract enforceability issue, that is step three of the paradigm.

The introductory materials present the historical basis for the Statute of Frauds-cautionary (parties pay more attention to what they are doing if what they are doing is in writing and requires a signature) and evidentiary (the writing stands on its own and does not require the parties to recollect or improvise). This discussion is followed by an illustrative statute.

Contracts That Require a Writing and What Constitutes the Writing (296)
The threshold Statute of Frauds question is whether this type of contract needs to be in writing to be enforceable. If, for example, the contract cannot be fully

performed within one year, the contract is for the sale of an interest in land, or the contract is for the sale of goods for the price of $500 or more, the contract must be in writing to be enforceable.

The threshold question is determined at the time of contract formation and not after performance. Therefore, the threshold question must be answered with foresight and not hindsight.

Contract Not to Be Performed within One Year (296)
The one-year period begins to run from the date of contract formation. Example 9-2 illustrates the measuring technique.

The next paragraph discusses the question of probability of performance. The probability that the contract will be fully performed within one year from the date of contract formation is irrelevant. What is important is the possibility, no matter how slight, that performance could be completed within a year.

In PARALEGAL EXERCISE 9.1 (297) the actual construction time is irrelevant because the time determination is made with foresight and not hindsight. The time period (18 months) stated in the contract is irrelevant because that is the maximum time permitted and not the minimum. The question should be whether at the time of contract formation there was a possibility, no matter how slight, that the construction could be completed within one year. If yes, then the contract did not need to be in writing to be enforceable.

The next paragraph begins the discussion of the distinction between full performance and termination. Termination extinguishes the duty before the duty has been fully performed and is irrelevant for Statute of Frauds purposes. Full performance is the bench mark for the Statute of Frauds.

Example 9-3 (297) applies the distinction between full performance and termination.

PARALEGAL EXERCISE 9.2 (298) gives students an opportunity to practice on the distinction between full performance and termination.

1. The term of the contract is “for five years” so full performance is five years. The contract cannot be fully performed within one year from the date of contract formation so the contract must be in writing to be enforceable. If McBee dies before five years, his contractual duties are terminated. He has not fully performed.
2. The term is “as long as he can play football.” Atlas could have a career-ending injury within one year from the date of contract formation and full performance would be at that time. Therefore, since the contract could be fully performed within a year from the date of contract formation, the contract need not be in writing to be enforceable.

3. The term is “for five years, but . . .” so the contractual duties could be terminated in less than five years. The contract could be terminated prior to full performance. Full performance, however, requires five years so the contract must be in writing to be enforceable.

In PARALEGAL EXERCISE 9.3 (298), the term was for three years. Williams’s death terminates the contract prior to full performance. Because full performance requires three years, the contract must be in writing to be enforceable.

Once the determination is made that the contract cannot be fully performed within one year and, therefore, must be in writing to be enforceable, the question becomes one of what must be in the writing to satisfy the Statute of Frauds. The writing must be signed by the party against whom it will be enforced and must state the essential terms with reasonable certainty.

In PARALEGAL EXERCISE 9.4 (298), the term was for two years and, therefore, the contract had to be in writing to be enforceable. Because this was a contract that could not be fully performed within a year, its terms must be spelled out with reasonable certainty. Because the writing did not state the salary, it could not be enforced against Metro.

In PARALEGAL EXERCISE 9.5 (298), the term was for two years and, therefore, the contract had to be in writing to be enforceable. Because the writing was not signed by the magazine, Ava could not enforce the contract against it. The magazine could successfully claim that the contract was unenforceable under the Statute of Frauds.

PARALEGAL EXERCISE 9.6 (298) is a drafting exercise based on the facts of Paralegal Exercise 9-5. The projected law suit would be *Ava v. Magazine* for breach of contract. Therefore, the writing must be signed by the Magazine and its terms must be spelled out with reasonable certainty. Therefore, the writing must include salary, duration, and description of the work.

Contract for the Transfer of an Interest in Real Property (299)
Although a contract for the sale of an interest in land must be in writing to be enforceable, the rule is subject to the “part performance” exception. *Elizondo v. Gomez* (299) illustrates this exception.

Contract for the Sale of Goods for the Price of $500 or More (301)
This aspect of the Statute of Frauds is found in section 2-201 of the UCC. The threshold questions are: (1) Is this contract for the sale of goods? and (2) Is the price of the sale $500 or more?

PARALEGAL EXERCISE 9.7 (302) raises the threshold question of whether this transaction is for the sale of goods. The purchase and installation of overhead garage doors is a hybrid transaction-part sale and part service. The predominant

factor (predominant purpose) test, discussed in Chapter 1, is needed to resolve this issue.

Once the threshold questions have been resolved and it has been determined that a writing is required, the question becomes what must be in the writing. The paragraph after Paralegal Exercise 9.7 spells out the three elements for subsection 2-201(1):

1. the writing must evidence a contract for the sale of goods;
2. the party against whom enforcement is sought must sign it; and
3. the writing must specify a quantity, even though the quantity is inaccurate.

PARALEGAL EXERCISE 9.8 (302) asks for an application of these three elements. It would be safe to assume that the threshold questions can easily be resolved-the contract was for the sale of goods (5,000 six-ounce hamburger patties) and for the price of $500 or more (the price would have to be less than a dime apiece to bring the price below $500). If Mom & Pop's did not sign the purchase order form prepared by Quality's delivery person, the contract was unenforceable.

PARALEGAL EXERCISE 9.9 (303) is a drafting exercise based on the facts of Paralegal Exercise 9.8. The writing could be as simple as:

Mom & Pop's contracts to purchase and Quality Meats, Inc., contracts to sell 5,000 six ounce hamburger patties.

/s/ _____ /s/ _____
Mom & Pop's Quality Meats

The exceptions to subsection 2-201(1) are found in subsections (2) and (3).

Under subsection (1), a lack of signature from the party to be charged will not be fatal if the requirements of subsection (2) are met.

Subsection (2) has its own threshold question-the parties must be merchants. Therefore, both the buyer and the seller must be merchants. Merchant and merchants are defined in UCC §§ 2-104(1) and (3), respectively. Comment 2 to section 2-104 is extremely instructive. Comment 2, paragraph 1 identifies three types of merchants for Article 2 purposes: the merchant based on specialized knowledge of the goods; the merchant based on specialized knowledge of the business practices; and the merchant with specialized knowledge as to both. Not all Code sections require the same type of merchant. One code section may require a "goods" merchant while another may require a "business practice" merchant. Comment 2, paragraphs 2, 3, and 4 helps match the type of merchant to the Code section. UCC § 2-201(2) requires that both buyer and seller be

“business practice” merchants. The business practice of section 2-201(2) is that of making oral contracts followed by written confirmation.

Example 9-4 (304) initially deals with subsection (1) and then (2). This is a contract for the sale of goods (meat scraps) for the price of $500 or more ($10,000). The contract is unenforceable against the Zoo under UCC § 2-201(1) because the Zoo did not sign a writing.

Under subsection 2-201(2) the assumption is that the Zoo and Pacific are merchants (since both are members of a trade that uses oral contracts followed by a written confirmation). Now apply the facts to the elements for subsection 2-201(2).

1. Was a writing in confirmation of the contract sent within a reasonable time? (A confirmation of the oral contract was sent and there was no indication that it was not sent within a reasonable time.)
2. Was the writing sufficient against the sender? Had the party being charged been the one sending the confirmation, would the writing have met the subsection 2-201(1) requirements? (Had enforcement been sought against Pacific, the written confirmation would have been effective against Pacific under subsection 2-201(1) because it indicated a contract for sale had been made between the parties, it had a quantity, and was signed by Pacific.)
3. Did the party receiving the confirmation have reason to know of its contents? (If the Zoo was a merchant and an oral contract followed by a written confirmation were the practice between buyers and sellers of meat scraps, then the Zoo would have had reason to know of the contents of the confirmation.)
4. Did the party receiving the confirmation send written notice of objection to the contents of the confirmation within ten days after receiving it? (Evidence of written notice of objection did not appear in the facts.)

Therefore, under subsection 2-201(2), the contract was enforceable against the Zoo.

Next, three 2-201(3) exceptions are introduced: specially manufactured goods (Example 9-5) (304); admissions against interest in the pleadings or in court proceedings (Example 9-6 (304)); and payment and acceptance of the goods (Example 9-7) (305).

Circumventing the Statute of Frauds through Reliance (305)
A number of courts, probably a growing majority, will permit reliance to defeat a Statute of Frauds defense. The elements for reliance in this setting are listed following Restatement (Second) of Contracts § 139 (306). These elements are similar to the elements for reliance to circumvent the lack of consideration. See Restatement (Second) of Contracts § 90 (306).

Contract Not To Be Performed within One Year (307)
The Restatement (Second) of Contracts § 130 authorizes a party who has fully performed a contract that should have had a writing (did not satisfy the Statute of Frauds because it could not be fully performed within a year) to enforce the contract against the other contracting party.

Full performance by one party may not, however, be necessary for enforcement of a promise. The Restatement (Second) of Contracts § 139 (307) authorizes enforcement of a promise that has been relied upon even if neither party has fully performed.

Contract for the Transfer of an Interest in Real Property (307)
The Restatement (Second) of Contracts § 129 picks up the common law part performance doctrine.

Contract for the Sale of Goods for the Price of $500 or More (308)
Although UCC § 2-201(1) requires a writing unless the facts fit within subsections (2) or (3), some courts venture beyond these exceptions and enforce a contract that should have been in writing under UCC § 2-201(1) if the elements of Restatement (Second) of Contracts § 139 are met. Other courts adhere to a strict reading of UCC §2-201(1)-"Except as otherwise provided in this section"-and reject the application of Restatement (Second) of Contracts § 139 when the contract involves a sale of goods.

Warder & Lee Elevator, Inc. v. Britten (309) uses reliance to circumvent the Statute of Frauds. The court's opinion and the dissenting opinion in Warder & Lee present both sides of the issue.

Could Restitution Be a Cause of Action When the Contract Is Unenforceable Due to the Statute of Frauds? (315)
If a contract is unenforceable because it does not meet the Statute of Frauds requirements, a restitution action may be available to address any benefits conferred. See Restatement (Second) of Contracts § 375.

Contract That Cannot Be Fully Performed within a Year (316)
In Example 9-8 (316) if a restitution action is employed, the restitution remedy (reasonable value to the recipient of the benefit-i.e., the defendant) will be different from the expectation remedy (placing the nonbreaching party in the position he or she would have been in had the contract been fully performed) that would be available in a breach of contract action. The contract could not be fully performed within a year (two year term) and, therefore, needed to be in writing to be enforceable. Because the contract was oral it was unenforceable. The employee Weaver, however, could maintain a restitution cause of action to recover for his services which were conferred on General Metals. The measure of compensation would not be his back pay (this would be expectation) but

rather the reasonable value to the recipient, General Metals. If the reasonable value of his services equals his back pay, it is by coincidence and not by design.

Contract for the Transfer of an Interest in Real Property (316)
Examples 9-9 and 9-10 (317) illustrate the restitution action when the contract for the sale of an interest in land was oral. In Example 9-9, the vendee conferred the benefit on the vendor. In Example 9-10, the vendor has conferred a benefit on the vendee. The measure of recovery in both is reasonable value to the recipient.

PARALEGAL EXERCISE 9.10 (317) illustrates that to maintain a restitution cause of action, a benefit must be conferred by the plaintiff on the defendant. Since Sammy never conferred the hot dog stand on Cassandra (or, if conferred, received it back), no benefit was conferred. Therefore, Sammy could not maintain a restitution action against Cassandra. What Sammy has lost in the transaction is the difference in expectation between the two contracts.

This section is divided between illegality as a defense to a breach of contract action and restitution as a cause of action when illegality is a defense to a breach of contract action.

Illegality as a Defense to a Breach of Contract Action (318)
This subsection deals with three types of illegality: the illegality of the subject matter itself; the illegality that was used to procure the contract; and the illegality that was used to perform the contract.

Illegal Contract and Illegal Terms (318)
In PARALEGAL EXERCISE 9.11 (319), a state statute provides “No agreement by an employee to waive his or her rights to compensation under the worker’s compensation law shall be valid.” Because James’s contract with the Packing Company includes such a waiver, the subject matter of the contract is illegal. James could not sue the Packing Company for breach of his lifetime employment contract because the contract was unenforceable. Paralegal Exercise 9.11 was based on *James v. Vernon Calhoun Packing Co*., 486 S.W.2d 396 (Tex. Civ. App. 1972).

In PARALEGAL EXERCISE 9.12 (319), the brokerage fee was in violation of state law and, therefore, illegal. The contract was unenforceable regardless of whether the suit was by Hope or Cox. Paralegal Exercise 9.12 is a variation of the facts in *Cox Feedlots, Inc. v. Hope*, 498 S.W.2d 436 (Tex. Civ. App. 1973).

The text returns to the multistate transaction with the question of which state’s law determines the issue of the illegality of a contract. The general rule provides that the issue of the illegality of a contract is ordinarily determined in accordance with the law of the place where the contract is performed.

PARALEGAL EXERCISE 9.13 (319) is a multistate transaction. The contract formed in Michigan is to sell Michigan lottery tickets in Oklahoma. The sale of lottery tickets is legal in Michigan but illegal in Oklahoma. Because the contract is performed in Oklahoma and the sale of lottery tickets is illegal in Oklahoma, the contract is illegal and unenforceable. Alex could not successfully sue Carrie for breach of contract.

Oklahoma law should govern regardless of which state is the forum state because the law of the state of performance is the applicable law.

This subsection concludes with the covenant not to compete-a variety of illegal contract. Covenants not to compete involve either the sale of business or employment.

This paragraph states the rule for sale of a business: the covenant must protect a legitimate interest and be reasonable in terms of subject matter, geography, and duration.

We stress the legitimate interest in both the sale of a business and employment cases. The reasonableness of the covenant regarding subject matter, geography, and duration is evaluated in light of what is needed to protect this legitimate interest.

PARALEGAL EXERCISE 9.14 (320) deals with a covenant not to compete.

Whether the covenant is enforceable depends first on whether SIS has a legitimate interest to protect, and second, whether the covenant is reasonable vis-à-vis the legitimate interest to protect in terms of subject matter, geography, and duration.

SIS is seeking to protect what it bought from Rhodes (the enjoyment of the assets purchased). Should this interest be protected?

What protection does SIS need to safeguard its enjoyment of the assets purchased?

This involves:

(1) whether Rhodes's either directly or indirectly, owning, managing, operating, controlling, or participating in the ownership, management, operation of or control of, or being connected in any manner with, or assisting others in, the security business is reasonable vis-à-vis SIS's legitimate interest;
(2) whether a fifty mile radius from City Hall is a reasonable distance vis-à-vis SIS's legitimate interest; and

(3) whether two years from the date of Rhodes's selling his shares to SIS and leaving the company is a reasonable time vis-à-vis SIS's legitimate interest. Is more information needed before each question can be resolved? What is this information? For example, within how many miles radius from City Hall is SIS currently operating? If the good will of SIS is within five miles of City Hall, a five mile radius is sufficient to keep Rhodes from competing for the same customers. Fifty miles is unreasonable.

PARALEGAL EXERCISE 9.15 (328) deals with the covenant not to compete by an employee. What interest was Apex attempting to protect? Is a restriction against participating in the sale or service of fire protection and safety equipment reasonable in terms of the interest sought to be protected? Is the restriction from selling and servicing in Harris and Galveston Counties reasonable in terms of the interest sought to be protected? Is a two-year period reasonable in terms of the interest sought to be protected?

Covenants not to compete have been heavily litigated in recent years.

Illegal Conduct to Procure a Legal Contract (321)
The illegal conduct to procure is the "before" problem. The contract itself is not illegal.

Only the methods used in its procurement were illegal. A common example is the use of bribery to procure a contract.

Example 9-13 (321) is such a bribery-to-procure case.

Illegal Conduct in the Performance of a Legal Contract (322)
The illegal conduct in the performance is the "after" problem. The contract itself is not illegal. Only the methods used in the performance of the contract were illegal. *McConnell v. Commonwealth Pictures Corp*., 7 N.Y.2d 465, 166 N.E.2d 494 (1960) uses a major/minor, directly/indirectly test. Example 9-14 (322) was based on McConnell.

We have used the phrase "the illegality must be significant and must directly relate to the performance of the contract."

Could Restitution Be a Cause of Action when the Contract Is Unenforceable Due to Illegality? (322)
Because the contract is unenforceable due to illegality, the question becomes whether a restitution action can be maintained for any benefit conferred by one party on the other. The underlying policy that bars enforcement of the contract is also relevant in a restitution action and should bar the restitution action as well.

Several exceptions, however, do exist. The first, when the parties are not in pari delicto (equal fault), is illustrated by Abbott v. Maker (324). Marker, an attorney,

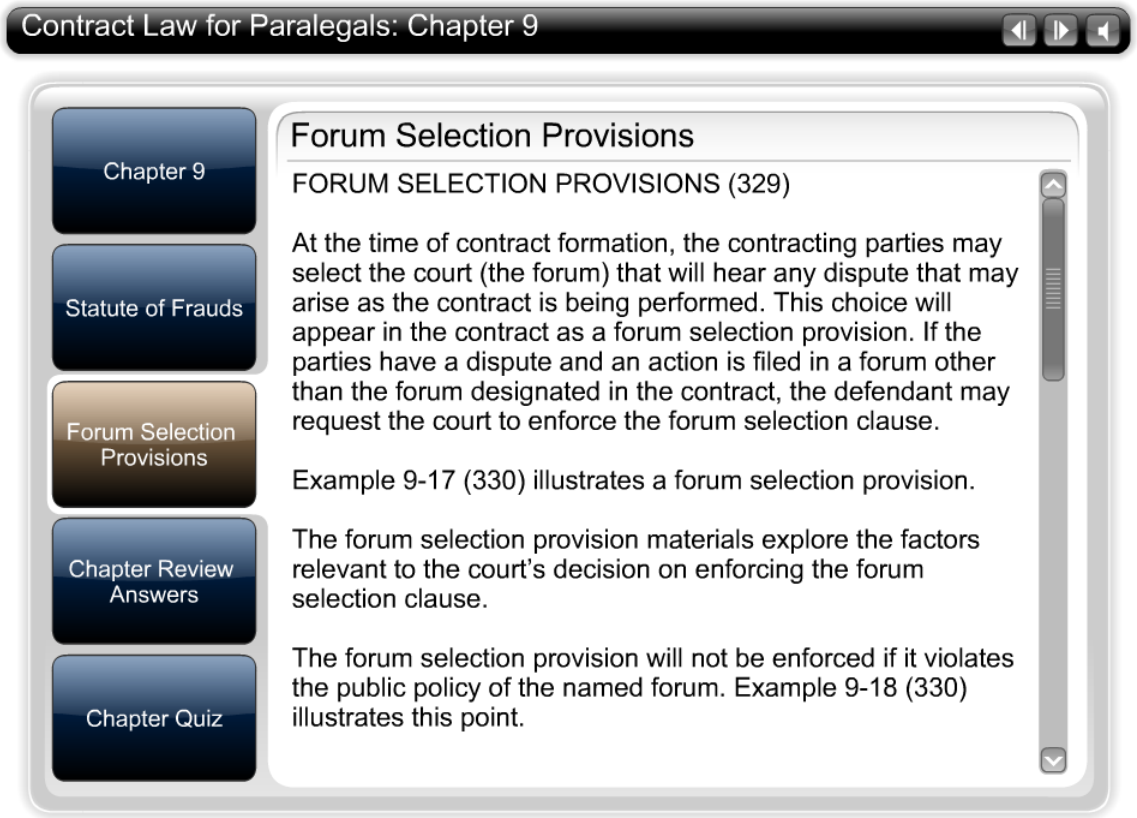
represented Abbott in a medical malpractice claim. After the claim was settled, Marker and Abbott entered into an illegal contract whereby Abbott would refer potential clients to Marker and they would split the fee. In one such referral, Marker earned $1.6 million in attorney fees but refused to pay Abbott his percentage. Abbott brought breach of contract and restitution (quasi-contract) actions against Marker. The trial court granted Marker's motion to dismiss. Abbott appealed contending that although the contract was illegal and against public policy, he was not in pari delicto with Marker and therefore the contract should be enforced in either contract or quasicontract (restitution). The Wisconsin Court of Appeals rejected the pari delicto exception as to the breach of contract action and rejected the benefit conferred element necessary for the restitution action.

The second exception, collateral illegality, arises when the illegality is not closely related to the plaintiff's cause of action and therefore should not pose an obstacle to either a breach of contract or restitution cause of action.

Example 9-15 (328), statement in the deed authorizing the selling of tobacco on Blackacre without paying state taxes, which was collateral to the conveyance of Blackacre itself. Therefore, any benefit conferred in regard to this covenant should be restored under a restitution action.

The third exception, "repentance," is the feeling of remorse or regret concerning one's actions. If a contracting party repents before the illegal objective of the contract is accomplished, some courts permit the repenting party to maintain a restitution cause of action to recover the benefit he or she conferred on the party who has not repented.

Forum Selection Provisions



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FORUM SELECTION PROVISIONS (329)

At the time of contract formation, the contracting parties may select the court (the forum) that will hear any dispute that may arise as the contract is being performed. This choice will appear in the contract as a forum selection provision. If the parties have a dispute and an action is filed in a forum other than the forum designated in the contract, the defendant may request the court to enforce the forum selection clause.

Example 9-17 (330) illustrates a forum selection provision.

The forum selection provision materials explore the factors relevant to the court's decision on enforcing the forum selection clause.

The forum selection provision will not be enforced if it violates the public policy of the named forum. Example 9-18 (330) illustrates this point.

The forum selection provision will not be enforced if it is unjust and unreasonable.

A provision is unreasonable if a trial in the named forum would create a serious inconvenience to any of the participants. Serious inconvenience must be such as to effectively deny a party his or her day in court. The excerpt from *Ronar, Inc. v. Wallace* (331) discusses the issue of convenience.

The forum selection provision may not be enforced if, at the time of contracting, one party held such a powerful bargaining position that the other was unable to effectively resist the inclusion of the forum selection provision.

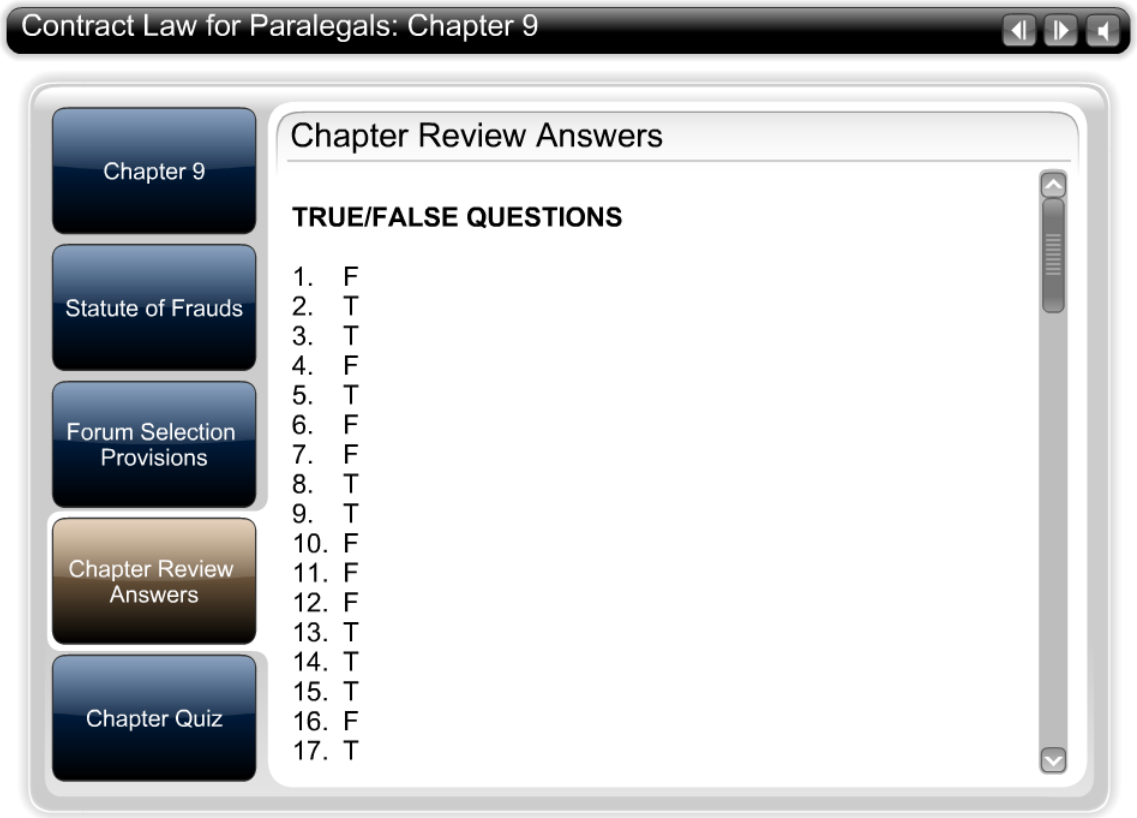
The forum selection provision will not be enforced if it is not exclusive.

In PARALEGAL EXERCISE 9.16 (333), students should be asked to comment on the application of these four factors.

Example 9-22 (334) (*Sterling Forest Associates, Ltd. v. Barnett-Range Corp*.) illustrates that the word “shall” does not guarantee that the named forum will be the exclusive forum. The court draws the distinction between “shall” and “must.” Students should comment on what motivated the court to make that determination. (The *Bremen v. Zapata Off-Shore Co*., cited in Sterling, is the leading case in this area.) Note in Sterling a motion for rehearing was granted and upon rehearing the court rescinded its order but affirmed the result reached in that order. *Sterling Forest Associates, Ltd. v. Barnett-Range Corp.,* 643 F. Supp. 530 (E.D.N.C. 1986). In the later opinion, the court shifts the emphasis from “shall” to the verb “to be.”

PARALEGAL EXERCISE 9.17 (336) makes the point that forum selection clauses also appear in international transactions. The four factors previously discussed should be applied to this forum selection provision.

Chapter Review Answers



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TRUE/FALSE QUESTIONS

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42. F
43. T

FILL-IN-THE-BLANK QUESTIONS

1. Illegal subject matter
2. Covenant not to compete
3. The business's goodwill
4. Disclosure of the employee's trade secrets or confidentiallists or an employee's services that are special, unique, or extraordinary 5. Parties are not in pari delicto, collateral illegality, repentance
6. In pari delicto
7. Collateral illegality
8. Repentance
9. Statute of Frauds
10. Restitution action
11. Forum selection clause

MULTIPLE-CHOICE QUESTIONS

1. b, c, & d

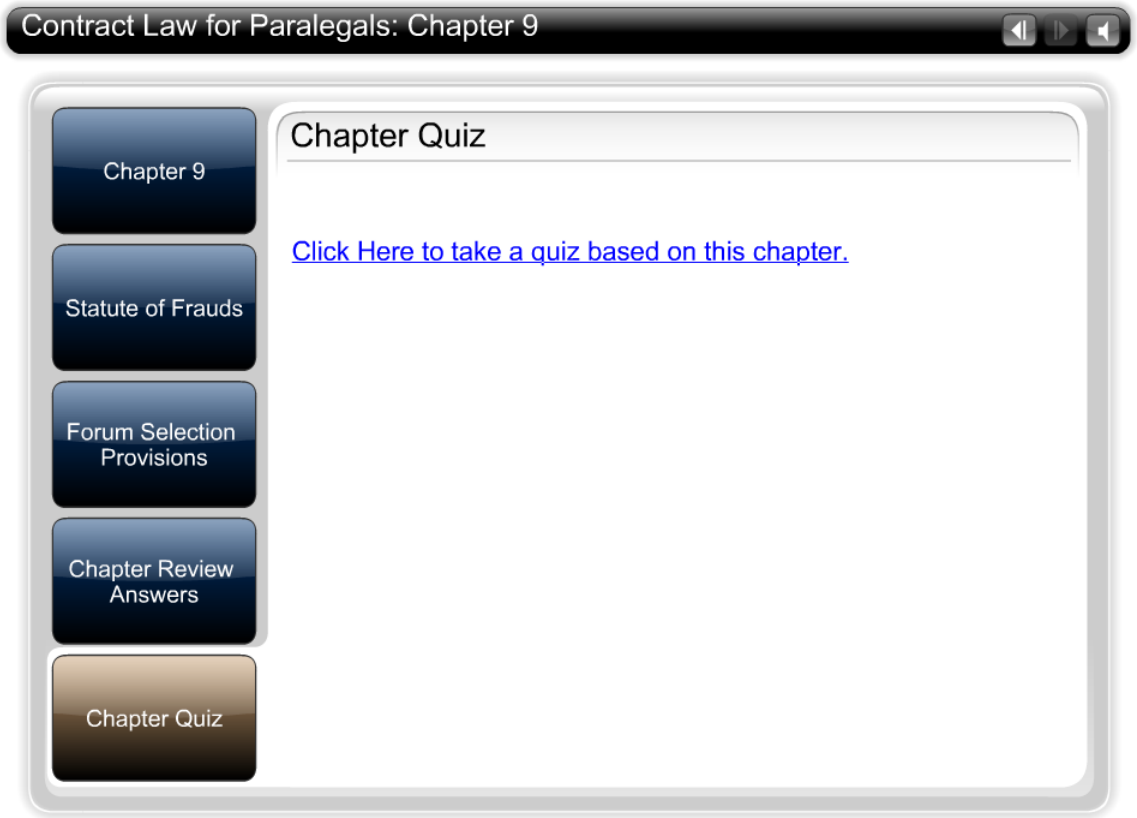
2. b

SHORT-ANSWER QUESTIONS

1. Ellen could use a covenant not to compete in a contract for the sale of a business to protect her purchase of the business's goodwill. The covenant must be drafted to protect this goodwill and must not be overly broad. Therefore, the covenant will be enforceable so long as it does not extend beyond the subject matter, geography and duration necessary to protect the business's goodwill. For example, if the Print Shop operates in three states, an eight state prohibition would be overly broad.

2. For an employee to be subject to an enforceable covenant not to compete, the employer must have a legitimate interest to protect. If the employee does not have access to the employer's trade secrets or confidential lists or if the employee's services are not special, unique, or extraordinary, the employer has no interest to protect. Without a legitimate interest to protect, any covenant not to compete between this employer and employee would be unreasonable and therefore unenforceable.

Chapter Quiz



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Click Here to take a quiz based on this chapter.