

#### 4-1 Legality: Which Agreements Are Illegal?

**Hot Debate:** A friend offered Stacey \$100 if he would “get rid of” a neighbor’s barking dog. “You’ll be the hero of this whole block,” the friend said. “Just take it far out of town and give it to some farmer,” said the friend. The dog had bitten a young boy who was teasing it. When neighbors reported the barking dog to the animal control office, the owners were always able to make the dog stop barking just before the officers arrived on the scene. Stacey agreed. He “got rid of” the dog and asked for the money. His friend refused to pay. Stacey sued his friend. Why should Stacey be able to collect the money? Why shouldn’t Stacey be able to collect the money?

#### Illegal Agreements

**What’s Your Verdict?** Razer agreed with several published articles that criticized laws prohibiting the production, possession, and use of marijuana. The authors of the articles claimed that such legislation was unrealistic and often violated civil rights. Razer agreed so heartily that he bought several dozen marijuana plants from a friend, Sara. Then, he rented a patch of isolated land and persuaded the owner to accept a share of the anticipated crop as rent. After harvesting the first crop, Razer sold his share to Sara. Were any of his agreements illegal?

Agreements can be void and unenforceable because they involve contracting for an illegal act. For example, if Sam contracted with Murder Inc. to shoot his ex-girlfriend and refused to pay after the homicide had been committed, Murder Incorporated could not win a suit against him for breach of contract. The contract between Sam and Murder Inc. is unenforceable because it is an illegal agreement.

On the other hand, other contracts can require a violation of the law and yet be enforceable. If you ordered stationery from a shop in a nearby mall but the business license of the shop had expired, the shop would be in technical violation of the law for engaging in business without the proper license. If the shop breaches the contract, could you sue and recover? Yes, you could. While there is a minor illegal act by the shop, you have not knowingly violated the law. How can we distinguish these kinds of cases? There are basically four ways.

- First, statutes sometimes explicitly state that certain contracts are unenforceable. For example, most states have statutes which make private betting contracts unenforceable.
- Second, courts look at the impact of violation of a statute on the public welfare. So even though the homicide statute says nothing about the enforceability of contracts to murder, courts would rule them void because they have a big impact (possible loss of a life) on the public welfare.
- Third, courts look at how directly the contract and the violation of the statute are connected. In the homicide example, the contract was for a homicide. In the business license example, the contract was for stationery.
- Fourth, the courts look at how involved the parties are in the violation of a statute. In the murder contract, one party did the murder and the other paid for the murder. This is deep involvement in violation of a homicide statute. On the other hand, when you ordered stationery, you were completely unaware that the shop’s business license had expired. There is no direct involvement on your part in violation of the law.

**Agreements to Commit Crimes & Torts.** Almost any agreement to commit a crime or a tort will be an illegal agreement. In **What’s Your Verdict?** all of Razer’s agreements were criminal and therefore void.

**Illegal Gambling.** Most states either forbid or regulate gambling. Typically, they have statutes which make gambling agreements void. Gambling involves an agreement with three elements: payment to participate, a chance to win based on luck rather than on skill, and a prize for one or more winners. A **wager**, one of the most common forms of gambling, is a bet on the uncertain outcome of an event, such as a football game. Most states have legalized some form of gambling under regulated conditions.

**Usury.** Almost all states provide that, with certain exceptions, lenders of money may not charge more than a specified maximum rate of interest. Generally, the penalties specified by these statutes vary. In some states, the lender cannot collect some or all of the interest. However, the borrower must usually repay the principal. The maximum interest rate varies among the states. Lending money at a rate higher than the state’s maximum allowable rate is **usury**. Sometimes a person borrows money for which interest will be charged but no exact rate is stated. In such a case, the rate to be paid is the legal rate of interest, which is specified by state statute.

**Discrimination.** Some agreements are unenforceable because they violate anti-discrimination statutes. For example, an agreement between a motel chain and a local manager to not accept guests of a particular race or national origin would be

unenforceable because it violates the federal Civil Rights Act of 1964. Agreements may also be illegal as violations of the Constitution. For example, a contract between a residential subdivision developer and a home buyer providing that the buyer would not sell to a member of a particular race would be unenforceable because it violates the Fourteenth Amendment to the Constitution.

Obstruction of Justice. Agreements that delay or prevent justice are void. Examples include promises to pay non-expert witnesses in a trial to testify, or pay for false testimony, bribe jurors, refrain from informing on or prosecuting an alleged crime in exchange for money, or other consideration. This is called **compounding a crime** (making it worse). The victim may not make reporting a crime dependent upon restitution.

---

***In This Case: After school, a new student named Judy robbed Melinda of \$400. Instead of reporting the crime to the police, Melinda confronted Judy three days later, told her to return the money, and threatened to call the police if she didn't. Judy said she would pay \$40 a week for 10 weeks. This agreement is void.***

---

Lack of Competency License. All states require that persons in certain occupations and businesses pass exams and receive a license to ensure that they are competent. Persons engaged in trades, such as barbers, plumbers, and electrical wiring installers typically require a competency license. Professionals such as physicians, teachers, lawyers, and pharmacists must have competency licenses. Real estate brokers, insurance agents, and building contractors are subject to such regulation. Persons who lack the required competency license may not enforce the contracts they make in doing the regulated work. In contrast, if the license is a **revenue license**, whose purpose is only to raise revenue rather than to protect the public, contracts made by the unlicensed person are still valid. Generally, the only penalty for failure to get such a license is a higher fee.

---

***In This Case: Shaun learned two computer programming languages in his spare time and started a business helping people create web pages. He operated out of his home after school and was earning \$3,000 a month. The city where Shaun lived required a business license to operate any business there. Shaun didn't have the license. When a client encountered financial difficulty, it refused to pay, saying Shaun was unlicensed. The client must pay because the business license only raises revenue, it does not regulate competency.***

---

Interference with Marriage. The law encourages marriage and family life by making agreements that harm or interfere with marriage unenforceable. For example, Mimi is an illegal immigrant and Bill is a U.S. citizen. It would be an illegal contract if Mimi agreed to pay Bill \$5,000 in exchange for his promise to marry her so she could obtain citizenship. Similarly, a father's promise to pay his daughter for not marrying would be unenforceable. Also it would be illegal for a boss to agree to pay her assistant in exchange for his promise to divorce his wife.

Price Fixing. Our economic system is based on the concept of free and open competition. This creates profits for producers who benefit consumers the most. Hence, both state and federal laws seek to prevent monopolies and combinations that restrict competition unreasonably. When competing firms agree on the same price to be charged for a product or service, this injures consumers. It deprives them of the lower prices which competition would produce. **Price fixing** is a crime under federal law. Agreements to fix prices are therefore unenforceable.

---

***In This Case: All ten pharmacy owners in the city of Weston meet to discuss common problems. During the discussion, they agree that all the stores would match the prices charged for certain items by a discount outlet that had recently opened in the town. They also agree that they will charge no less than specified minimum prices for some 50 other high-volume items. Because these agreements restrained free trade and controlled prices, they were illegal and void.***

---

Resale Price Maintenance. Manufacturers engage in **resale price maintenance** when they want retailers to sell their product at particular prices. They may identify a "suggested retail price." This is legal. However, manufacturers may not agree or contract with retailers to sell the product at a particular price because that would involve two parties fixing the price. On the other hand, manufacturers can identify a suggested price and refuse to sell to retailers who do not adhere to the price.

---

***In This Case: Colgate manufactured and sold soap to retailers. It identified suggested retail prices and refused to sell to retailers who did not adhere to the prices. The government prosecuted Colgate for a form of price fixing called resale price maintenance. The Supreme Court ruled that this activity is legal as long as there is no agreement between retailers and Colgate and as long as Colgate does nothing to enforce resale price maintenance.***

---

Allocation of Markets. The same injury to competition produced by price fixing can be achieved if competitors divide markets between themselves. This practice is known as **allocation of markets**. If the Ford dealers in a state agree that they will not sell

to residents outside the county where their dealership is located, this eliminates price competition for Fords and injures consumers. Therefore agreements to allocate markets are illegal and unenforceable.

Covenants Not to Compete. Price fixing and market allocations are agreements not to compete. One type of agreement not to compete is sometimes enforceable. When persons are hired they may agree that they will not compete with their employer after the employment terminates. But these covenants not to compete become illegal if they are unreasonable in:

- time period for the limitation
- geographic area to which the limitation applies
- employer’s interest must be protected by the limitation

An agreement not to compete for 20 years would likely be illegal. Often an agreement not to compete anywhere in the United States is ruled to be illegal. In contrast, an agreement not to engage in the printing business for five years in the city or county where the former employer is located probably would be enforceable. The employer’s interests protected by the covenant not to compete must be significant. Trade secrets are the most commonly recognized employer interests.

### Think Critically About Evidence

1. Crump owned a restaurant. She applied to the state liquor control board for a \$500 license to sell alcohol. When the application was denied, Lynch, a customer, told Crump that he knew someone on the board and could get her a license for \$7,500. Crump paid Lynch the money but never received the license. Can she recover the money?
2. Dixon, a wholesaler, was on the brink of bankruptcy. He bought fire insurance policies for more than twice the value of the building and contents from two companies. Then he arranged to pay a character known only as “Sparky” \$10,000 to “torch” his business building. Was the agreement with Sparky valid? Could Dixon legally collect on his insurance policies if Sparky torched the building?
3. A remote community and the surrounding countryside had no doctor. The city council advertised for help, offering free office space, a six-bed infirmary, and a three-year contract. Glamorgan applied and was accepted. Three months later, the council learned that although Glamorgan had a medical degree, she had failed to pass the state examination required to practice medicine. No patients complained, but the council summarily discharged her. Glamorgan sued for breach of contract. Will she win the lawsuit?

## 4-2 Legality: Enforceability of Illegal Agreements

### How Do Courts Treat Parties to Illegal Contracts?

*What’s Your Verdict? A young couple, the Guptas, wanted to provide for the college education of their infant daughter. They received this offer in the mail from the True Bonanza Mining Corporation, which seemed perfect for their need: “Join us now for only 10 cents a share of stock. Become part owner of a gold and silver mine with already proven mineral deposits. In ten years, you will be rich enough to retire!” The Guptas used all their savings to buy 10,000 shares of Bonanza stock. Months later, they learned that Bonanza had violated the law. Its “proven mineral reserves” were commercially worthless aluminum oxides. The sales agreement was illegal. Can the Guptas recover their \$1,000?*

Courts generally will help neither party to an illegal agreement. Courts will not enforce the agreement. Further, courts will leave the parties where they are. This is so even if one party has performed and the other has not. If you’ve already paid Murder Inc. and they haven’t done the job, you can’t get restitution – recovery of your payment. However, there are five major exceptions to these rules.

### Protected Victims

In some cases the law that was violated was designed to protect a party to the agreement. For example, blue-sky laws prohibit sales of worthless stocks and bonds. Such securities have no more value than a section of the blue sky. The victim may obtain restitution to recover money paid. Thus, in *What’s Your Verdict?* restitution would be available to the Guptas. Parties to an illegal agreement are often not equally blameworthy. For example, by lying one party might persuade a gullible person to enter an illegal agreement. Where the illegal agreement was created by fraud, duress, misrepresentation or undue influence, the victim may obtain restitution as a **protected victim**.

### Excusably Ignorant

The excusably ignorant can either enforce the legal part of the contract or obtain restitution. A person is **excusably ignorant** who does not know the contract is illegal, but the other party knows the transaction is illegal, and the illegality is minor.

*In This Case: Cindy agreed to star in a series of plays in summer stock at Shoreside Theater. The theater, however, had not been inspected for building code compliance after recent minor renovations. The theater knew this. Cindy did not. Cindy's ignorance of this fact is excusable because it would be very difficult for her to determine this. While failure to obtain the inspections is usually serious, this may not be the case if the renovations are minor. Therefore Cindy can enforce the legal part of the contract. If the theater owner had not been aware of the failure to inspect, Cindy could not enforce the agreement.*

### **Rescission before the Illegal Act**

If a party rescinds before the illegal act occurs, then restitution will be available. For example, if you paid \$50 to another student to steal an advance copy of a final exam, then changed your mind and called off the deal before the theft, you could recover the \$50 payment. The exception for **rescission before the illegal act** creates an incentive to stop illegal acts.

### **Divisible Contracts**

Illegal contracts often contain a combination of legal and illegal provisions. Courts may enforce the legal part of a contract if it is divisible. **Divisible contracts** are agreements where separate consideration was given for the legal and illegal parts of the contract. Suppose a retailer contracts to sell camping and hunting supplies, including a pistol. If the seller fails to comply with a state law that requires a 30-day waiting period for the sale of a handgun, this part of the contract is illegal. However, a court would probably enforce the legal provisions of the contract because the amount paid for the pistol (illegal part) can be distinguished from the amount paid for everything else (legal part).

### **Unconscionable Contracts**

An **unconscionable contract** is a grossly unfair contract that parties under ordinary circumstances would not accept. Unconscionability has two elements: procedural and substantive. Most courts require both procedural and substantive unconscionability before it is deemed to be an unconscionable contract and illegal.

- **Procedural unconscionability** is shown by how the contract is created. Procedural unconscionability arises when contracts contain very fine print, light typesetting or elements of fraud, duress, undue influence, or misrepresentation. It can also be established by showing that a party had no real alternatives, was time pressured, or possessed unequal bargaining power.
- **Substantive unconscionability** is established by terms of the agreement. Substantive unconscionability arises from unfair terms in the agreement (a very high price or very one-sided terms).

### **Think Critically About Evidence**

1. A new boss was scheduled to take over Patty's department in three weeks. Patty agreed to pay Nancy \$600 to remove unflattering information from her personnel file so she would look good to the new boss. The day before Nancy was going to do it, Patty called and told her not to. She also asked for her money back. Nancy never took the information. Could Patty sue and recover her money?
2. Randy entered into a contract to provide a computer program to a school district. He used without permission parts of a computer program copyrighted by another programmer. The portion of the program that violated the copyright law cost \$12,000 and the part that didn't violate the law cost \$44,000. He delivered both parts to the school district. Can he recover anything for his work?
3. Cliff worked as a site manager for an oil-drilling company. When a drill bit broke, he called Texas Bit Company, a bit manufacturer. Cliff asked for a bit able to cut quickly through granite. The salesperson recommended their model 2123 which was described as a high carbon steel bit with diamonds embedded on the cutting edges. The salesperson quoted a fair price but she said there were no warranties and that the product was being sold, "as is." This is an unusual practice in this industry. Cliff didn't think he could get that type of bit from anyone else without a big delay, so he ordered it. It turned out that the bit was made only of low-carbon steel and it cut very slowly. Is this an unconscionable contract?
4. A door-to-door salesperson appeared at Jamaya's front door selling encyclopedias. The set cost more than \$600 for the hardbound deluxe edition. She signed the contract and paid \$200 with the balance due when the books were delivered in 30 days. When the books arrived, she refused to pay. Jamaya claimed the contract was illegal because the salesperson didn't have a business license to operate in her city. If the allegation can be proven, can Jamaya recover the \$200 she paid?
5. The Franklins, Ali and Lomalinda, had no medical insurance and urgently needed money for emergency surgery for their infant child. They could not qualify for a bank loan and they did not belong to a credit union. An acquaintance referred them to someone named "Slye, who'll lend you money on sight. No collateral. No credit report. Just show him you've got a steady job." The Franklins borrowed \$2,500 from Slye and agreed to pay \$325 on the first of each month "in 12 easy installments." Later a lawyer told them that the loan contract was illegal. Was it? How much money must the Franklins repay?
6. Trent, a minor, bought a copyrighted compact disc recording of a current hit from Shawn. After making a copy of the disc, Trent found a defect in the CD. He tried to return it to Shawn for a full refund. Shawn suspected the illegal copying and refused the refund. Can Shawn assert illegality as a defense here? Did Trent act legally and ethically in making a copy?
7. Moser had no automobile liability insurance, although state law required it. She negligently collided with Chang's car. Chang threatened to call the police 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. If Chang sues, will she recover?

### 4-3 Written Contracts: What is the Statute of Frauds?

**Hot Debate:** Anne promised her best friend, Sally, that she would pay for all Sally's wedding expenses if Sally would pay Anne's college tuition for a semester. Sally paid the tuition of \$3,200. Time passed and the friends fell out of touch. After 12 years, Sally became engaged. When she contacted Anne about paying for the wedding, Anne said she didn't remember the promise. Why should Anne be required to pay for the wedding? Why shouldn't she have to pay?

#### Must All Contracts Be In Writing?

**What's Your Verdict?** While they are playing golf, Haka orally agreed to buy an apartment building from Simon. In a later phone conversation, Haka promised Simon \$100,000 as a down payment on the purchase price with the balance to be paid within five years. Simon promised to deliver the deed to the property at the time the down payment was made. Both parties were satisfied that all the terms had been completely negotiated. Later Haka found a better deal and told Simon he was backing out. Is the contract enforceable?

Certain contracts are not enforceable in court unless a signed writing proves their existence. For example, contracts to transfer an interest in real property (land, buildings, and things permanently attached to them) must be evidenced by a writing and signed by the party against whom enforcement is sought. In What's Your Verdict? the oral agreement between Haka and Simon would not be enforceable.

Most contracts are enforceable even if there is no writing, or written proof. But just because a contract is unenforceable, it is not necessarily illegal. The parties may choose to carry out their agreement even if it does not meet the legal requirements for a writing.

Enforceable contracts can be created in face-to-face conversation. For example, in the sale of goods, payment by buyer and delivery by seller often occur at the time the agreement is made. A person may enter many other business agreements without the formality of a written contract. Sometimes a contract may be implied from conduct. For example, a person may hail a bus board it, deposit the proper coins, and later get off. No words are spoken or written by either passenger or driver, yet there is a valid contract.

**In This Case:** Simon owned a 14-foot sailboat. Carl admired it and asked Simon if he would sell it. Simon said, "Yes, for \$480." Carl said "That's a fair offer, but I just don't have that much money." He counteroffered at \$380. Simon said, "Okay, I'll sell her to you for the \$380." This was an acceptance of Carl's counteroffer and created a contract. This contract is enforceable, though nothing was placed in writing and no one even shook hands. Most oral contracts are enforceable.

#### What Is the Statute of Frauds?

**What's Your Verdict?** When the general manager of Special-Teas Sales Company hired Bellini as advertising manager for a five-year period, the two parties discussed the terms of employment and then shook hands. As Bellini later recalled, her beginning salary was to be \$3,000 a month but it would go up annually as sales rose. At the end of the first year, she expected a pay increase of at least \$500 a month, but there was no increase at all. She threatened to quit. The manager admitted that sales were up. However, he claimed that expenses had also risen and therefore profits were down. He threatened to sue Bellini for breach of contract if she left. Can the manager enforce this contract against Bellini?

In early England, plaintiffs and defendants would often commit **perjury**. That is, they would lie under oath to prove a contract, though none really existed. To address this problem, England adopted a statute in 1677 that required certain contracts to be in writing and be signed by the party against whom the contract was to be enforced in court. Because the statute was designed to prevent fraud and perjury, it was called the Statute for the Prevention of Frauds and Perjuries.

The name statute of frauds is now commonly used to designate statutes that require certain contracts to be evidenced by a signed writing in order to be enforceable in court. The writing need not be a formal contract itself. The writing may consist of a letter or a sales slip if such writing identifies the necessary information.

#### Contracts Within the Statute of Frauds

A contract is said to be within the **statute of frauds** if it is required to be in writing. Contracts within the statute of frauds are:

- contracts to buy and sell goods for a price of \$500 or more
- contracts to buy and sell real property or any interest in real property
- contracts that require more than one year to complete

- promises to pay the debt or answer for a legal obligation of another person

It is without the statute of frauds if it is not required to be in writing. If a contract is within the statute of frauds, but there is either no writing or no signature, how courts will treat the parties depends on the extent of contractual performance.

### Contractual Performance

Executed Contracts. An **executed contract** is one that has been fully performed. Both parties have done all they promised to do. If an executed contract is within the statute of frauds, but there is either no writing or no signature, the courts leave the parties where they are. Neither party can reverse the contract.

---

*In This Case: You order a five-dish carryout Chinese dinner at Imperial Garden Café. When the meal is ready, you give the cashier the purchase price and receive five cartons of food in an insulated bag. This is an executed contract because it has been fully performed by both parties.*

---

Executory Contracts. An **executory contract** is one that has not been fully performed. Something agreed upon remains to be done by one or both of the parties. An executory contract within the statute of frauds, but not signed or not in writing, is unenforceable. This means neither party can compel performance from the other. In *What's Your Verdict?* the employment contract cannot be enforced since it was unwritten and it required more than a year to complete. The executory contract in violation of the statute of frauds is different from an illegal contract. One way is that restitution is available. Further, if a benefit was conferred in reliance on the oral agreement, its value can be recovered. It is recovered by suing based on quasi-contract. A **quasi-contract** exists when some element of an enforceable contract is missing (such as a signed writing), yet courts award money to prevent the unjust enrichment of one party.

---

*In This Case: Peg and Paul Dowell ordered "Steak of the Month" from a mail-order company in Texas. They paid \$220 by check, which the seller cashed. Just before Christmas, two large Porterhouse steaks were delivered. During each of the following 11 months a different steak was to be delivered. The contract will be executory until all promised steaks are delivered. Then it will be an executed contract.*

---

### What Type of Writing Does the Statute Require?

---

*What's Your Verdict? Sue orally agreed to provide interior decorating services for a law firm for two years at a rate she found attractive. She wrote a signed letter to the law firm expressing her appreciation for the business, which she described as "interior decorating services, not to exceed 10 hours per week." The law firm replied with its own signed letter which described the transaction as "services for 24 months at \$3,500 a month." Do these writings satisfy the statute of frauds?*

---

A writing does not need to be in any specific form to satisfy the statute of frauds.

Multiple Writings. A series of writings – such as an exchange of letters, telegrams, or faxed messages – is sufficient. In *What's Your Verdict?* the two letters satisfy the statute. The writing may be printed, typed, or handwritten with pen or pencil.

Content Requirements. What must the writing contain? There is great variability. States have adopted statutes that differ significantly. In general, the writing must contain all the essential terms that would be required to create a valid offer. This would typically include: names of the parties, description of the subject matter, price, quantity, other essential terms, and a signature. "Other essential terms" can include time or method of delivery, terms of payment, methods of financing, date for transfer of possession and so forth, depending upon the nature of the transaction.

Because the standards vary so much from state to state, it is a good practice to ensure that, in important transactions, all the essential terms are included in the writing.

Signature Requirement. Under the original statute, only a signing party could be successfully sued on the contract. That remains the law for many types of transactions under the statute of frauds. So if there is only one signature, only one of the parties may be able to enforce the contract. This legal reality has led to the practice of asking the party on the other side to sign and then treating the transaction as concluded without signing yourself. This produces the unfair result that the party who doesn't sign can back out while the signing party cannot.

The signature may be written, stamped, engraved, or printed. It may consist of any mark that is intended as a signature or authentication of the writing. The purpose of the statute is to prevent frauds by requiring proof of the contract's existence that is hard to fake; signatures are somewhat hard to forge.

**Think Critically About Evidence**

1. Sheila walked into the local Wal-Mart, chose a \$20 dress, walked to the checkout counter, paid for the dress in cash and left the store. Is this agreement executory or executed? Is this a completely valid contract even though nothing was placed in writing?
2. Jeanne went to SOHO, a local dress shop. She found a dress she liked for \$180 and asked if she could put it on layaway. The owner said, "Yes, but you've got to put \$20 down and pay at least \$20 a week until it is paid." Jeanne said, "Okay," and paid the \$20. Is the store bound by this agreement even if nothing was placed in writing?
3. Julian agreed with a national auto parts chain to pay \$900 for a remanufactured engine for his older car. He took delivery of the engine and paid the money, though nothing was placed in writing. Two days later he saw an ad by another chain offering the same engine for \$600. Is this contract within or without the statute of frauds? Is it executory or executed? Can Julian withdraw from the agreement because nothing was placed in writing?

**4-4 Written Contracts: Contracts Within and Exceptions to the Statute of Frauds****What Contracts Are Within the Statute of Frauds?**

*What's Your Verdict? Cervante and Joan were good friends. When they graduated from high school, both were 18. They planned to marry, but first they wanted to become financially secure. So they shook hands and agreed to become partners in operating a small restaurant serving Indian cuisine. "This is just the beginning," Joan said. "'Til death do us part!" both said. Are they legally bound to remain partners in business until one dies?*

To be enforceable under the statute of frauds, five important types of executory contracts must be evidenced by a writing and signed by the party against whom the contract is to be enforced. As an alternative, the contract may be provable by some other writing, such as a letter signed by the party who is being sued. A plaintiff seeking to enforce the contract can readily sign if his or her signature is missing. Since either party might later want to sue for breach, both parties should sign when the contract is made.

Remember, contracts that fall within the statute of frauds are:

- contracts to buy and sell goods for a price of \$500 or more;
- contracts to buy and sell real property or any interest in real property;
- contracts that require more than one year to complete; and
- promises to pay the debt or answer for a legal obligation of another person.

*In This Case: Khan bought a new car and wanted to sell her old car. She advertised in the local paper and Khazari agreed to buy the car for \$1,885. He promised to pay and to take delivery when he received his paycheck in two weeks. If Khan refused to sell as promised, Khazari could enforce their agreement only if Khan had signed their agreement. On the other hand, if Khazari refused to buy as promised, Khan could collect damages only if Khazari had signed.*

**Contracts for Goods ≥ \$500**

If parties agree to buy and sell goods (such as a book, car, or TV) for a price of \$500 or more, their contract must be evidenced by a writing. If a contract for the sale of goods is for less than \$500, then it need not be in writing. However, a modification of that contract which brings the total price above \$500 must be in writing and signed.

*In This Case: Don orally agreed with a gun shop to buy a used rifle (a good) for \$480. This agreement is without the statute of frauds. However, Don called the shop the next day and asked them to add a used 7x scope for the gun which cost an additional \$100. Because this modification moves the total price above the \$500 mark, the agreement must be placed in writing to be enforceable.*

**Contracts for Real Property**

Real property includes land and buildings permanently attached to land. Transfers of real property or of lesser interests—such as a lease, the right to pump oil or to cut timber—must be in a properly signed writing to be enforceable. In most states, oral leases for one year or less are enforceable. Some states require that contracts employing real estate brokers satisfy the statute of frauds. As an exception to the general rule, courts will enforce the oral contract if the seller has delivered the deed

or if the buyer has also done all of the following: made partial or full payment, occupied the land, and made substantial improvements to the land

---

*In This Case: The Schmidts orally agreed to sell their mountain cabin, and the Cardonas orally agreed to buy it. The price agreed upon was \$28,950. Before the oral contract was executed, the Schmidts got a better offer in writing from Murata. Could the Cardonas still hold the Schmidts to their original oral promise to sell for the agree-upon price? No, the Cardonas cannot hold the Schmidts to their oral promise to sell. However, since Murata made his offer (to buy) in writing, the Schmidts could hold him to this promise.*

---

### **Contracts that Require More than One Year to Complete**

Courts will not enforce a contract that cannot be performed within one year unless there is a signed writing to prove the agreement. The year begins at the time the contract is made, not at the time contractual performance is to begin. This time provision does not apply to agreements that might be executed within one year. This is true even if such agreements are not actually carried out within that time. The test is not whether the agreement is actually performed within one year, but whether there is a possibility of performance within one year.

---

*In This Case: Late in March, Bulger, the human resources manager of Data Dot Data Inc., orally promised to employ Gramling in the company's processing department. The job was to be for eleven months at \$2,000 a month plus a customary package of fringe benefits. Gramling was to report for work a month after receiving her high school diploma the following June. Gramling discussed the offer with her parents. The next day she telephoned Bulger and accepted. However, this agreement was not an enforceable contract by either party. When Gramling reported for work as promised, Bulger said, "Sorry, business is too slow. We've changed our minds." The oral agreement was not enforceable because the contract required more than a year to complete, even though the employment period was for less than a year.*

---

### **Contract to Pay a Debt of Another Person**

Another provision of the statute of frauds requires a writing for a promise to answer for the debt or default of another. So if Dad tells his daughter's landlord that he will pay the rent if she defaults on a three-month lease, this promise is called a **collateral promise**. It must be in writing to be enforceable. This contrasts with a primary promise to pay. A primary promise exists if Dad says, "I'll rent the apartment and you bill me. Then I'll let my daughter stay there." This agreement is enforceable without a writing. Often a person dies without enough assets to pay all the debts. In these cases, the person in charge of settling the deceased person's unpaid debts (often a relative) may agree to pay the debt personally instead of trying to pay it from the deceased person's assets. This is a promise to answer for the debts of another. Such a promise is not enforceable unless placed in writing.

---

*In This Case: Puccini predicted a revival of "one-man bands" featuring accordion music. Mike's Music Box shop has the accordion Puccini needed but it cost \$1,495. Puccini had neither the necessary cash nor credit. His friend, Muniz, told the music shop owner, "Sell Puccini the accordion on a 15-month installment contract. If he fails to make any payment, I will pay any balance due." After three months, Puccini defaulted. However, the oral promise Muniz made is not enforceable. If Muniz had said, "Sell the accordion to Puccini, but bill me. I will pay you," it would have been a promise to the seller. As such, the oral promise would have been enforceable in court.*

---

**Exception: Main Purpose Rule.** A third party is liable for an oral promise to pay another's debt if the main purpose of the promise serves the promisor's own interest. This is called the **main purpose rule**. Suppose an owner of a house under construction is anxious to see it completed. After the building contractor fails to pay on time, the driver of the delivery truck refuses to unload a shipment of lumber. If the homeowner orally promise to pay the lumberyard if the contractor doesn't pay for needed supplies, the homeowner cannot defend using the statute of frauds. The main purpose rule applies.

### **Think Critically About Evidence**

1. Suzy entered into an oral contract with Hugh for the purchase of 16 used CDs by country and western singers. Suzy handed over the \$300 price and Hugh gave her the 16 CDs. Is this transaction within the statute of frauds?
2. Jack and Ted were in a sporting goods store looking at exercise equipment. Jack wanted to buy a set of weights but he didn't have the cash or the credit. Ted orally told the owner of the store that he would pay if Jack didn't make his payments on time. Jack got the weights and took them home. Is Ted's promise primary or collateral? Does it fall under the main purpose rule? Is the transaction with Ted enforceable in court?
3. Jason's father, Phil, died. He left credit card bills totaling \$17,000 and some additional small bills. His only asset at the time of death was a savings account with \$6,000 in it. One of the credit card companies called Jason. In his grief, Jason orally promised to pay them the balance on his dad's account, \$2,000. Is this promise enforceable in court?

#### 4-5 Written Contracts: How Are Contracts Interpreted?

##### What Is the Parol Evidence Rule?

*What's Your Verdict? Highman bought a new personal computer from Advance Electronics. She signed the store's usual contract, which contained a clause stating that it was the complete agreement between the parties. Later, Highman alleged that as part of the bargain, the salesperson orally promised that if the list price were reduced within two months, Highman would be refunded the amount of the reduction. The list price was reduced, but Advanced Electronics refused to pay the refund to Highman. Can Highman recover the refund?*

Parties sometimes make enforceable oral agreements. Other times, part of the agreement is oral and part is in writing. Frequently the parties place the whole agreement in writing. Some writings are intended to be the final and complete agreement between the parties. Such final and complete writings invoke the parol evidence rule.

To determine whether a writing is intended by the parties to be the complete agreement, the courts look at the length and detail of the writing. Often, writings will be clear on this issue by including an **integration clause**. An example of an integration clause is: "It is agreed that the terms written here constitute the entire and final contract between the parties."

##### Consequences of Applying the Parol Evidence Rule

With certain exceptions, the **parol evidence rule** will bar testimony about what was said prior to the execution of the final writing or at the time of signing. This makes the final writing the source of evidence about the terms of the contract. Thus, if a complete final written agreement for the sale of a house is signed, then a court will not admit oral testimony that, prior to the parties' signing the written agreement the seller had said he would paint the exterior before vacating.

The rule keeps out preliminary inquiries, initial proposals, negotiations, and other discussions that are not the final agreement. These inadmissible spoken words are called parol statements or parol evidence. In *What's Your Verdict? Highman* could not recover the refund. Evidence of the salesperson's oral promise would be parol evidence. In complete and final writings, both parties should carefully include all terms that they deem essential.

##### Exceptions to Parol Evidence Rule

Even when there is a written agreement or an integration clause, parol evidence may be admissible. Parol evidence is admissible:

- to clarify ambiguities in the written agreement
- if the written contract was not intended to be a complete agreement
- if a condition necessary to the existence of the contract never occurred
- if genuine agreement was missing, or if there was forgery or illegality
- to show the parties reached another agreement or terminated the contract under consideration after executing the written contract to show that the contract is voidable because a party lacked capacity

##### How Are Conflicts In Written Terms Interpreted?

*What's Your Verdict? Milo contracted with Corrigan for the installation of a complete burglar alarm system for \$2,900. The printed standard form contract provided that Milo was to pay \$900 down and the balance at \$100 a month for 20 months. Failure to pay any installment when due would accelerate the debt and make the entire balance due. The payments were to be made on the first day of each month. Milo explained that he did not receive his paycheck until the tenth. Therefore, he said he would prefer to make the payments on that date. Corrigan agreed and in the margin wrote in "tenth" and initialed it on Milo's copy only. During the first month, Corrigan demanded the full balance when Milo failed to make the first payment on the first. Is Corrigan entitled to the full balance immediately?*

Even when parties put their agreement into a signed contract, the written words may be unclear or require interpretation. This sometimes happens when filling in blanks on standard forms. Also, modifying terms on a standard form may cause contradictions among terms. Further, one party may use a word that seems perfectly clear, yet it has a totally different meaning for the other party.

If there is a conflict between the typeset print and something typewritten or handwritten, the later writings, not the conflicting typeset print, determines the contract's meaning. This is because the writing is likely to have occurred after the typesetting. Similarly a typewritten agreement which includes a conflicting handwritten statement or clause will be

interpreted based on the handwritten portion. In *What's Your Verdict?* the handwritten modification prevails over the typeset, so Corrigan is not entitled to the full balance immediately.

When contracts refer to amounts of money, they often describe the amount with numerals, such as “10,” and also with words such as “ten.” If there is a conflict between the numeral and the word, and one of them is ambiguous, then the unambiguous expression will prevail. For example, “Two twenty-five dollars (\$2.25)” will be interpreted by reliance on the numerals. When both the writing and the numerals are unambiguous, then the writing prevails. For example, “Two hundred twenty five and 00/100 (\$235.00)” will be interpreted in reliance on the words. This is because more mistakes are made when writing numerals.

The first thing a court will do is interpret the contract in terms of the parties' principal objective. By looking at the main objective, courts can see which clauses should prevail over others. Further, if an agreement can be interpreted in two ways, the courts will choose the way that renders the agreement a contract. Interpreting each clause in the light of all other provisions of the contract is another way to follow the parties' principal objective. Every word is given effect if this is reasonable.

#### **Think Critically About Evidence**

1. A salesperson tries to persuade you to buy an electronic musical instrument. The price is \$499, plus carrying charges of \$72. The salesperson says, “You'll soon be the life of the party. If not, just return it and get your money back.” You sign an installment payment contract, which includes an integration clause but which says nothing about a return privilege. Can you hold the seller to the promise to accept a return?
2. Silvio Development Company bought an insurance policy to cover the risk of damage to its corporate helicopter. For coverage, the standard printed insurance policy required that every pilot of the plane be licensed by the Federal Aviation Agency (FAA) and have a minimum of 500 logged (recorded by the pilot) flying hours. A typewritten addition specified that every pilot had to have a minimum of 200 logged helicopter flying hours. When the plane crashed, the pilot had logged only 75 helicopter flying hours. However, she was FAA licensed and had logged more than 2,000 flying hours in conventional planes. Must the insurance company pay?
3. When Torres leased an apartment from Leon, they used a printed form provided by Leon, the landlord. One sentence stated: “No advance deposits shall be required other than for one month's rent.” However, Leon had typed in: “Tenant shall pay a \$400 refundable cleaning and repair deposit upon taking possession. No charge shall be made for ordinary wear and tear.” Torres drew a line through the \$400 and wrote in \$200. Both parties signed and each received a copy of the lease. Which provision governs the refundable deposit—the printed (\$0), the typewritten (\$400), or the handwritten (\$200)?
4. Under a written contract, Cabrera bought a used sedan from Sharpe's Previously Owned Cars Inc. The salesperson had knowingly falsely assured her that the car was in “tip-top condition. . . with just 45,000 miles driven by only one previous owner.” Later, in checking official registration records, Cabrera discovered that the sedan had three previous owners and that the odometer had been set back from 70,000 miles. In court, Sharpe's attorney claims that under the parol evidence rule, introduction of the salesperson's oral statements is barred because there was an integration clause in the written contract. Is this parol evidence admissible?
5. During the final week of Al's junior year at East High, an officer from Granite Inc. offered him a job. “After you get that diploma,” the officer said, “show up ready for work.” “I'll be there,” Al replied. Was this a contract enforceable in court?
6. Van and Trip are competent adults. Under a written contract, Van bought Trip's motor scooter for \$800. Van gave Trip a check for \$300 as a down payment and took delivery of the scooter. On the way home, she bought some gas at a self-service station and got a granola bar from a vending machine. How would you classify these contracts as to extent of performance?
7. Bruno bought Hummel's condominium using a written contract. The title was to be transferred in 30 days. Bruno then orally agreed to buy specified items of Hummel's furniture for the lump sum of \$2,800. When she took possession of the condominium, however, she decided not to buy any of the furniture. Is Bruno legally permitted to change her mind this way without any legal liability to Hummel? Is such conduct ethical?
8. Central-Cal Lands Corp. orally agreed to sell a 640-acre ranch to Ceres Inc. for \$3,280,000. Ceres paid \$125,000 and immediately took possession. Can Central-Cal legally withdraw from the agreement?
9. Kelley was admitted to University Hospital as an emergency heart transplant patient. The next day, the hospital's business manager discussed the cost of the surgery with Kelley's two sons. Both sons told the manager, “Do whatever is necessary to save his life, and we will pay you.” When the hospital presented the staggering bill to the junior Kelleys, they said the contract was oral and, therefore, they were not liable. Is that true?