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Contract Law Principles

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The word "contract" is likely to conjure images of a lengthy, densely-worded tome that is comprehensible, if at all, only by lawyers. But contracts are part of everyday life. Turn over your car keys to the parking garage attendant and a contract (known as a bailment) is created: you agree to pay a fee in exchange for the storage and return of your car. When you go to the video store, you either buy a movie (a contract of sale) or borrow one (a contract of lease). These simple transactions are contracts because the definition of a contract is simply "a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."[1]

Contracts also are an integral part of business life, including the construction industry: signing and returning an engagement letter; requesting and using a quote in a bid to an owner; acknowledging and accepting a purchase order. Again, these everyday acts, often done without much thought, can create a contractual relationship between the parties, one that carries with it legal obligations and responsibilities.

Because a contract is a voluntary act, the general rule is that contracting parties are free to undertake any obligation that is not prohibited by law, public policy, or public morals.[2] Lawful contractual obligations, freely undertaken by a party, are generally enforceable, no matter how onerous or uneconomic the obligation might seem in hindsight. Simply stated, "courts do not unmake bargains unwisely made."[3] Accordingly, it is important to understand how contract are created and interpreted by the courts before signing on the dotted line.

Contract Formation

As a general rule, the necessary ingredients of a valid contract are 1) capacity, i.e., parties legally capable of contracting; 2) their consent legally given; 3) a definite object that forms the subject matter of the agreement; 4) a lawful purpose; and, 5) consideration, i.e., mutual obligations flowing between the parties.

"Capacity" refers to the competence of a person to make (or accept) a legally binding promise. The law generally presumes that all persons have capacity to contract, except minors, interdicts, and persons lacking mental capacity at the time of contracting. In other words, capacity is the rule, and lack of capacity is the exception. As a result, capacity rarely is an issue in commercial contract lawsuits. The notable exception, however, is where the authority of a corporate employee to execute a contract on behalf of his employer is disputed.

"Consent" refers to the mutual agreement of the parties, which is evidenced by the extension of an offer by one party (the "offeror"), and an acceptance of it by the other party (the "offeree"). An offer is a proposal to make a contract that is communicated to the offeree for acceptance or rejection. Unless the contract is required by law to be in a particular form (e.g., contracts for the sale of real estate are required to be in writing), an offer may be made orally or in writing.

An offer that does not specify a period of time for acceptance is revocable any time before it is accepted. An offer that does specify a period of time for acceptance usually is irrevocable until that period ends. In the construction arena, the question of revocability typically arises when a subcontractor or supplier gives a contractor a quote that is then used in a bid to an owner. In this situation, the quote generally is deemed irrevocable for a reasonable period of time.

Acceptance occurs when the recipient communicates to the offeror his agreement to make a contract on the terms proposed. In this regard, an acceptance must be identical to the offer to result in a contract. An "acceptance" that adds, deletes, or otherwise seeks to change the terms of

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the offer is not an acceptance, but a counter-offer. Like the offer, an acceptance does not need to be in a particular form unless the law or the offer requires acceptance in a specific form. Indeed, an offer may be accepted by conduct that, under the circumstances, clearly indicates consent. For example, by informing a supplier its quote is "low" and using it in a bid, a contractor may be deemed to have accepted that quote if a contract is awarded by the owner.[4]

As noted earlier, parties have considerable freedom to contract for any object that is lawful, possible, and determined or determinable. A contract with an unlawful object, e.g., drugs, gambling, prostitution, murder-for-hire, is not enforceable. The object of a contract must be determined or determinable. A contract to draft plans and specifications for the mechanical systems of an office building would be an example of a contract with a determined object. A requirements or output contract would be an example of a contract with a determinable object.

The last element of a valid contract is "consideration." Consideration has been defined in many different ways over the years. Some legal commentators consider it to be the cause, motive, price or other influence that induces one to enter into a contract. Other commentators look at consideration from the standpoint of an act or inaction that confers a benefit on one party while imposing a detriment on the other. Currently, "consideration" is defined as a bargained for exchange of value between the parties to a contract.[5] In the construction context, design services are provided in exchange for fees and reimbursement of costs; labor and materials to construct a building are provided in exchange for stipulated compensation.

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Contract Interpretation

Contracts create mutual obligations between the parties. These obligations can be express (an obligation imposed by the express terms of the agreement) or implied (inferred from the fact that the parties have entered into a contractual relationship).[6] When disputes arise, courts or arbitrators are called upon to define these obligations by interpreting the contract. The goal of contract interpretation is to determine the common intent of the parties.

In interpreting a contract, the threshold issue courts face is whether the terms of the contract are clear and explicit, or ambiguous. If a contract is clear and unambiguous on its face, a court may look only at the language of the contract, i.e., within the "four corners" of the agreement, to determine the intent of the parties. In such circumstances, extrinsic evidence, also known as "parole evidence," may not be used to vary or modify the terms of the otherwise clear contract. As with most rules, however, there are exceptions. For example, parole evidence may be used to show that the contract does not completely express the agreements between the parties, or to show post-execution modification of the contract.

If a contract is found ambiguous, the court will consider parole evidence, such as testimony of the parties and documentary evidence to determine the intent of the parties. In making this determination, courts generally adhere to the following guiding principles of contract interpretation:[7]

Intent of the Parties is Paramount. Words, provisions, and other conduct are interpreted in the light of all circumstances, and great weight is given to the principal purpose of the parties, if it is ascertainable.

Contract Interpreted as a Whole. Courts interpret the contract as a whole, with all writings that are part of the transaction interpreted together. Contract provisions are given an interpretation that gives effect to all parts of the agreement, rather than one that neutralizes or ignores parts of the agreement. In other words, courts assume that provisions are included in a contract for a reason, and an interpretation that gives meaning to all terms is preferred to one that causes parts of the contract to lack effect.

Generally Prevailing Meaning. Courts generally interpret the words of a contract to have their common and ordinary meaning, unless the circumstances indicate that a different meaning should apply. Where words may reasonably be given different meanings, they are given the interpretation that best conforms to the overall object of the contract.

Technical Terms. An exception to the "generally prevailing meaning rule" occurs when the parties use words of art or technical terms in the contract. Such words are given their technical meaning by the courts—particularly when the contract involves a technical matter—unless the circumstances indicate that a different meaning should apply.

Context. Courts define vague terms according to the principle of *noscitur a sociis*, "it is known from its associates." If an ambiguous word is included within in a list, courts will look at the other words in the list to ascertain the meaning of the ambiguous word. For example, the term "other reasonable costs" in a list of recoverable costs may be limited to direct costs if the provision only lists direct costs.

Conduct. This principle is simply practical application of the axiom "actions speak louder than words." The parties to a contract, quite obviously, are in the best position to know their own intent. Often their actions or inactions during the course of performance are the best indicators what they meant, and the strongest evidence of their understanding of the terms of the contract.

Equity and Usage (Industry Custom). Closely related to

the parties' conduct is the concept of equity and usage. An ambiguous provision will be interpreted in light of the nature of the contract at issue, industry custom and practice, and other similar contracts between the parties.

Construed Against Drafter. Where an ambiguity cannot be otherwise resolved, the ambiguous provision is interpreted against the party who furnished its text.

These guiding principles are not given equal weight by the courts. For example, express contract terms from which intent can be inferred will be given greater weight than the parties' conduct, their past course of dealings, and industry custom and usage. Specific terms are given greater weight than general language, and separately negotiated terms are given greater weight than standard contract "boilerplate."

Conclusion

Ambiguity is the mother of all contract disputes. In addition to providing fertile grounds for dispute, ambiguity opens the door for the introduction of parole evidence, evidence that can muddy waters further rather than clear them. The best defense against a contract claim is a clear and unambiguous contract that fully expresses the parties' respective rights and obligations.

Notes

1. Restatement (Second) of Contracts § 1.
2. *R.J. Ducote Contractor, Inc. v. L.H. Bossier, Inc.*, 192 So.2d 179,182 (La. App. 1st Cir. 1966) ("so long as the terms of an agreement contravene no prohibitory law and are not contra bonos mores, neither the wisdom nor effect thereof is any concern of the courts").
3. *Robert Lawrence Assoc. Inc. v. Del Vecchio,* 410 A.2d 1142 (Conn. 1979).
4. *A&W Sheet Metal, Inc. v. Berg Mechanical, Inc.*, 653 So.2d 158 (La. App. 4th Cir. 1995).
5. Restatement (Second) of Contracts § 71.
6. One such implied obligation is the owner's warranty of the plans and specifications he furnishes to a contractor: e.g., *United States v. Spearin*, 248 U.S. 132, 136 (1918) ("[If] the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications.").
7. *See generally* Restatement (Second) of Contracts §§ 202 & 203.