

Introduction to Contracts

Caroline Bradley¹

Most commercial outlines and many casebooks begin the study of contract law with a focus on **formalities**: the legal requirements for the formation of a binding contract. The formal requirements of a contract are stated as **offer**, **acceptance** and **consideration**. These are legal terms of art: the words have specific meaning for lawyers that they do not have in everyday life. Non-lawyers may use the word “offer” to mean a number of different sorts of act. But when a lawyer considers whether words spoken or written by a person constitute an “offer” the acceptance of which can create a contract, she is using the word in a very specific way. Lawyers need to learn to be very careful about what words they use because some words have very specific legal meanings, and because **ambiguity** (the use of words that do not have clear meanings) creates opportunities for litigation.

However, while the legal term “offer” has a specific meaning, different lawyers may have different views on whether a given set of spoken or written words actually does constitute an “offer.” And figuring out whether a set of words constitutes an “offer” involves thinking not just about the words (contract law is not about magic incantations) but also about the circumstances in which they were spoken/written. Stewart Macaulay (one of the authors of our casebook) has written (in an article I will later ask you to read): “The more you know about language, the less comfortable you are with ideas that any collection of words has but one complete and clear meaning apart from context.”²

Different possible views about how to think about the words and their **context** are the basis for lawyers to make arguments. The aim is to distinguish between the sort of promises a court will enforce as a binding contract and words which do not constitute promises or which do not constitute the sort of promises the law will enforce as a binding contract.

¹ © Caroline Bradley 2015. All rights reserved..

² Stewart Macaulay, *The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules*, 66 MODERN LAW REVIEW 44, 48 (2003).

Even where the legal formalities of offer, acceptance and consideration are satisfied, and the lawyers for both sides recognize there is no scope for dispute about these issues, there may not be a binding contract. If two people agree to do an **illegal** act³ the agreement will not be treated as a binding contract. If one person lies to persuade another to enter into an agreement the **fraud**⁴ will prevent a court from enforcing the agreement as a binding contract. If one person pressurizes another into making an agreement a court may find that the pressure (the “**duress**”) means that the agreement should not be enforced as a binding contract. We will consider issues of this type (involving issues of “public policy”) at the end of the semester. For now you do not need to know anything about the details of illegality, fraud or duress, but it is a good idea to bear in mind that there are some **public policy** limits to the ability to contract.

Lawyers do need to know about the formalities of contract creation. But disputes about contracts that give rise to litigation are often about **interpretation** of the contract rather than about whether a contract exists, or about what remedies are available where there is a breach of a contract. You will be/have been a party to many contracts: ongoing contracts like leases or cellphone contracts or agreements for student loans, or one-off contracts for the purchase of goods.

During the semester we are going to see some examples of issues relating to contract law that arise in some different contexts, such as agreements between family members (where the parties may not focus at all on issues of formalities), employment and franchising. But we are going to begin by thinking about agreements whereby one person agrees to lend money to another. A binding contract for a loan will be created if one person promises to lend money to another and the borrower promises to pay something for the loan and to repay the borrowed amount. Offer and acceptance would in these circumstances generally involve the lender presenting a document to the prospective borrower containing the lender’s terms (this is the offer). When the borrower signs the document this is the borrower’s acceptance of the offer. Consideration here would be the mutual promises of the parties: the promise to lend the money and the promise to pay interest and repay the loan.

³ An act is illegal if the law prohibits it. For example a contract to buy and sell illegal drugs would be an illegal, and therefore unenforceable, contract.

⁴ Fraud in the inducement is an intentional misstatement of a material fact to induce another to enter into a contract.

Let us think about some different examples of loans:

1. Angela agrees to lend her son, Bob, money to cover the security deposit for the apartment he is renting, because he does not have enough savings to cover the deposit. Angela tells Bob “You can pay me back when you can afford to” but she doesn’t really intend to make a fuss about getting the money back.
2. Carol agrees to lend her son, Dave, money to cover the security deposit for the apartment he is renting. Carol thinks that in two years’ time Dave should have been able to save enough money to repay the loan. She gives Dave a document which states “I, Carol, promise to pay you, Dave, the sum of \$2000 for a security deposit for the apartment at 111 Elm Street, Elbowville. You Dave, promise to repay the amount of \$2000 on December 1, 2017. Both Carol and Dave sign the document.
3. Student Loans Company lends Fred the money he needs to pay for college (this is a private student loan). After Fred graduates he cannot find a job that pays well and finds it difficult to repay the loans. Fred’s loans include a range of provisions that he worries about, such as ““universal default” clauses (that have been interpreted to allow a loan to be placed in default if the borrower is not in good standing on an unrelated loan held by the lender, such as a credit card), clauses that permit a default if a lender believes the prospect of an obligor repaying their loan is impaired (even if the loan is otherwise in good standing), and clauses that may be interpreted to permit a default when a borrower does not quickly notify the lender of a name change or address change.”⁵ Student Loans Company has indicated to Fred that it plans to place his loans in default and require immediate repayment because it believes that the prospect of his ability to repay is impaired. Student Loans Company plans to go after Fred’s co-signor, his mother, for repayment of the loans.

The CFPB report cited in note 3 states (at p. 14) that where student loans are securitized (the loans are packaged together on the basis that the interest payments will be used to pay investors in bonds) the firms responsible for servicing the loans may decide to treat loans as being in default under such provisions even though the original lender might have made a business decision not to enforce the provisions.

⁵ This language is from the Consumer Financial Protection Bureau’s (CFPB) Report, Mid-year Update on Student Loan Complaints (June 2015) at pp. 12-13 (see http://files.consumerfinance.gov/f/201506_cfpb_mid-year-update-on-student-loan-complaints.pdf .)

4. Greece issues debt securities. The purchasers of the debt securities (investors) pay money to Greece (this is like a loan) and Greece promises to make interest payments to the investors and to repay the principal (the amount the investors paid to Greece) at a specific time in the future. But Greece finds that it does not have the financial resources to meet its commitments. The investors demand that Greece implements austerity measures that will reduce pensions payable to Greek workers. But Greek citizens are unhappy about the austerity measures and elect a new populist Government with a mandate to renegotiate Greece's debt. Greece's creditors insist on the maintenance of austerity measures, and Greek voters in a referendum reject the creditors' demands. Nevertheless the Greek Government makes concessions to the creditors and negotiations continue. But the International Monetary Fund (IMF) concludes that Greek debt is unsustainable (Greece will be unable to repay the debt on current terms given its economic condition) and that debt relief is necessary (i.e. a debt write-off or a reduction in the total amount of debt Greece would be treated as owing).⁶

All four of these examples involve the borrowing of money. But how the law treats the obligations of the parties varies in the different situations. If the borrowers in the 4 examples have difficulties repaying the money they have borrowed what do you think the legal rights of the lenders should be? Do you think the lenders in the different situations should have the same rights or different rights?

⁶ IMF, An Update of IMF's Preliminary Public Debt Sustainability Analysis, IMF Country Report No. 15/186 (Jul. 14, 2015).