

The Purpose of the Contract



A contract establishes the terms of the parties' relationship, and their agreement to the rules that will govern their transaction such as:

- The statement of facts made by each party that caused the other party to enter into the contract;
- Each party's promises as to its future performance;
- Each party's rights;
- The events that must occur before each party is obligated to perform;
- Each party's discretionary authority;
- How the contract will end, including the events that constitute breach and the remedies for breach; and
- The general policies that govern the parties' relationship.

7 Contractual Concepts



1. **Representations**-a statement of a past or present fact, made as of a moment in time intended to induce a party's reliance.
2. **Warranty**-A promise that the maker of the statement will indemnify the other party for any as related to damages suffered if the promise turns out to be false.
3. **Covenant**-A promise to do or not do something.
4. **Right**-Entitles a party to the other party's performance
5. **Condition to an obligation**- a state of facts that must exist *before* a party is obligated to perform.
6. **Discretionary Authority**- Gives a party a choice or permission to act.
7. **Declaration**-A fact as to which both parties agree.

Representation vs. Warranty

REPRESENTATION:

- 1) A statement of fact; 2) as of a moment in time; 3) intended to induce reliance
- A party can make representations about past and present facts, but not about future facts.
- Statements about future facts are mere opinions.
- To have a cause of action for ***mis***representation, the party must **justifiably** rely on the other party's statement.

WARRANTY

- 1) A promise; 2) by the maker of a statement; 3) that the statement is true
- If the promise is false, the statement maker must pay damages to statement's recipient.
- It does not matter if the recipient knew the statement was false.
- Both representations and warranties are common law concepts.

Remedies for Misrepresentation

3 Types of Misrepresentation (Torts Claim):

1. Innocent- must be material to support a remedy
 2. Negligent- must be material to support a remedy
 3. Fraudulent- remedy depends upon the jurisdiction
- If a misrepresentation is innocent or negligent, the usual remedies are **avoidance** and **restitutionary recovery**.
 - Avoidance (also known as rescission) allows the injured party to undo the contract.
 - Restitutionary recovery requires each party to return to the other what is received, either in kind, or if necessary, in money.

Remedies for Misrepresentation

- Fraudulent misrepresentations are made with knowledge of the falsity (**scienter**).
- If the misrepresentation is fraudulent, the injured party has a choice of remedies: 1) void the contract and seek restitution or 2) affirm the contract, retain its benefits, and sue for damages based on a claim of fraudulent misrepresentation.
- The injured party's damages claim can also include punitive damages.

REMEDIES FOR BREACH OF WARRANTY (CONTRACT CLAIM)

- The remedy for a breach of warranty claim is full benefit of the bargain damages.

QUIZ TIME!

RISK ALLOCATION

- **Risk Allocation-** The degree of risk that each party assumes with respect to a statement varies depending upon how broadly or narrowly the statement is defined.
- **Flat Representation-** This is an absolute statement meaning there is no wiggle room with interpreting how the statement is defined in terms of determining whether the statement is false.
- **Qualified Representation-** The person making the statement makes a less precise statement thereby reducing his or her risk of having an action initiated against him or her for misrepresentation and breach of warranty.

Covenants/Degrees of Obligation/Rights

- Covenant- A promise to do or not to do something. It creates a duty to perform. The duty to perform is sometimes called the obligation to perform.
- Closing- when parties exchange the agreed performances. EX: Closing on a home.
- Degrees of Obligation- The business differences between the different ways of expressing a party's obligations.
- Rights-flows from another party's duty to perform. It flows from a covenant. The person to whom the performance is owed has a right to that performance.

Conditions to Obligations

& The Exercise of Rights

- **Condition-** A state of facts that must exist before a party is obligated to perform. If that state of facts does not exist, the obligation to perform is not triggered.
- **Ongoing Condition-** Conditions that if not satisfied do not affect the parties' ongoing contractual relationship.
- **Walk-Away Conditions-Conditions** that if not satisfied permit a party to choose whether to perform or not perform.
- **Walk-Away Right-** The right to walk away from the deal without performing, with that non-performance ***not*** being a contract breach. This right arises **only if** the condition is a walk-away condition.
- Walk-Away Conditions and Walk-Away Rights are *sometimes* related to a party's performance of a covenant.

Discretionary Authority

- Discretionary Authority gives its holder a choice **or** permission to act. The holder **may** exercise the authority, but is not required to do so. The other party is bound by the holder's decision.
- A person who has discretionary authority is sometimes said to have a privilege.
- Discretionary authority allocates risk by subjecting the party without the discretion to the consequences of the actions of the party with the discretionary authority.
- **Condition to Discretionary Authority-** A state of facts that must exist before a party may exercise its discretionary authority.

Declarations

- Declaration-A Statement of facts as to which the parties agree.
- A party cannot sue on a declaration as no rights or remedies are associated with the declaration.
- Some declarations have *legal* effect on their own, but no *substantive* effect, except when inserted into another provision.
- Other declarations have a substantive effect on their own.
- All definitions are declarations.
 - EX: “Purchase Price” means \$200,000
 - “Property” means the home located at 5739 Century Drive
- A condition to a declaration is a state of facts that must exist *before* a policy has substantive consequences.



Building Blocks

<u>TERMINOLOGY</u>	<u>DEFINITION</u>	<u>BUSINESS PURPOSE</u>	<u>REMEDY</u>
Representation	Statement of fact as of moment in time intended to induce reliance.	To induce reliance; to establish standards of liability; to allocate risk.	For a material, innocent or negligent misrepresentation, avoidance and restitutionary recovery. For a fraudulent misrepresentation, either: 1) Avoidance & restitutionary recovery, or 2) damages & possibly punitives
Warranty	A promise that a statement is true.	To provide an indemnity if a statement is not true; to allocate risk.	Damages.
Covenant	A promise to do or not to do something. A covenant establishes a duty, also called an obligation to perform.	To require or prohibit action; to establish standards of liability; to allocated risk.	Damages, and if appropriate, specific performance. If the breach is so material that it is a breach of the whole contract that cannot be cured, then a party may have a right to cancel as well as other remedies.



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<u>TERMINOLOGY</u>	<u>DEFINITION</u>	<u>BUSINESS PURPOSE</u>	<u>REMEDY</u>
Right	A party's entitlement to the other party's performance of a covenant. A right is the flip side of a covenant.	To require or prohibit action; to establish standards of liability; to allocate risk.	The same as for a covenant.
Condition to an Obligation	A state of fact that must exist before a party is obligated to perform. The occurrence of the condition must be uncertain.	To establish when a party is obligated to perform a covenant; to allocate risk.	A condition to an obligation cannot be breached. Its failure to occur means that the obligation to perform is not triggered. If the failed condition does not affect the parties' ongoing relationship, the condition is an ongoing condition. If the failed condition permits one party to choose whether to perform, the condition is a walk-away condition that creates a walk-away right.
Discretionary Authority	The right to choose what action to take; permission to act.	To provide choice or permission; to allocate risk.	N/A

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<u>TERMINOLOGY</u>	<u>DEFINITION</u>	<u>BUSINESS PURPOSE</u>	<u>REMEDY</u>
Condition to Discretionary Authority	A state of facts that must exist before a party may exercise discretionary authority.	To establish when discretionary authority may be exercised; to allocate risk.	N/A
Declaration	Statement of fact as to which the parties agree.	To create definitions and establish policies.	N/A
Condition to a Declaration	A state of facts that must exist before a policy has substantive consequences.	To establish when a policy is applicable.	N/A