

WELCOME

Lecture Two

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graph TD; LT[Lecture Two] -- "Section 1" --> S1[Defenses to Contract Formation<br/>The Parol Evidence Rule<br/>Promise versus Condition]; LT -- "Section 2" --> S2[Rules of Interpretation<br/>Implied Covenant of Good Faith and Fair Dealing<br/>Waiver, Modification];
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Section 1

**Defenses to
Contract Formation**

**The Parol Evidence
Rule**

**Promise versus
Condition**

Section 2

**Rules of
Interpretation**

**Implied Covenant
of Good Faith and
Fair Dealing**

**Waiver,
Modification**

Lecture Two



Defenses to Contract Formation

DEFENSES TO CONTRACT FORMATION

Defenses to Contract Formation

Defenses to Contract Formation

Illegality

A contract must not require one or both parties to do something prohibited by law. If it does, all or part of the contract will be unenforceable, depending on the facts. A contract to traffic in endangered species, for example, would be unenforceable between the parties, allowing either party to back out.

The same would be true of a contract to commit murder, fraud, or even a “tortious act” on a third party, including trespass, misrepresentation, defamation or contractual interference. Interestingly, amounts paid toward the performance of an illegal contract generally cannot be recovered in a civil lawsuit.

Defenses to Contract Formation

Defenses to Contract Formation

Against Public Policy

Even absent a specific rule or statute, a contract or a specific provision in a contract may be found by a court to be “against public policy.”

Depending on the circumstances, a court may invalidate all or part of the agreement or refuse to provide a remedy for breach of the agreement. Courts vary in how they define what is “against public policy,”

Defenses to Contract Formation

Defenses to Contract Formation

Against Public Policy

“An agreement is against public policy if it is injurious to the interests of the public, contravenes some established interest of society, violates some public statute, is against good morals, tends to interfere with the public welfare or safety, or is at war with the interests of society or in conflict with the morals of the time.

Lecture Two



The Parol Evidence Rule

THE PAROL EVIDENCE RULE

The Parol Evidence Rule

THE PAROL EVIDENCE RULE

What is it?

The parol evidence rule is a legal evidence rule that applies to written contracts. Written contracts are complete and final agreements outlining obligations between parties and enforceable by law. Specifically, the parol evidence definition is the evidence pertaining to an agreement that isn't included in the written contract.

Parol evidence is, in simplest terms, evidence regarding discussions about what a contractual agreement should contain before entering into the contract. In other words, if you hire someone to paint your house, and in the process of negotiating the contract you also mention that you would like them to caulk around your windows, but the contract you subsequently enter into does not include anything about caulking, those discussions are parol evidence.

The Parol Evidence Rule

THE PAROL EVIDENCE RULE

What is it?

The problem with parol evidence is that it is generally inadmissible at trial. So, if you were to sue that painter on a breach of contract theory, you would not be able to submit evidence that you had discussed having the caulking done if that provision did not make its way into the final contract. Why? The courts believe that parties must know and understand agreements they enter into, and will not hold parties liable for things that are omitted. Maybe it was left out because of a concern about the additional cost of performing the caulking work, maybe it was just an honest oversight. But, whatever the reason, it was not in the final contract, so it cannot be the cause of a breach of the contract. As such, it is not relevant, and is therefore inadmissible.

The Parol Evidence Rule

THE PAROL EVIDENCE RULE

What is it?

The parol evidence rule provides that, where parties have a signed agreement, it is not generally permissible to adduce extrinsic evidence to:

- show what the parties' intention was in entering that agreement
- contradict, vary or add to the terms of the written agreement—this extends to implied terms

The Parol Evidence Rule

THE PAROL EVIDENCE RULE

What is it?

The parol evidence rule operates to exclude not only oral evidence, but all forms of evidence outside the contract itself such as:

- earlier drafts of the agreement between the parties

- preliminary agreements

The Parol Evidence Rule

THE PAROL EVIDENCE RULE

Expectations to the Parol Evidence Rule

In a perfect world, all contracts would be drafted with precision and foresight, clearly and comprehensively describing the parties' intentions and accounting for the unexpected. Reality being what it is, not every contract meets this standard. As a result, courts have created a number of important exceptions to the prohibition against evidence "outside of the four corners" of a contract, i.e., not found within the contract language itself.

The Parol Evidence Rule

THE PAROL EVIDENCE RULE

Expectations to the Parol Evidence Rule

The following exceptions to the Parol Evidence Rule are often important in contract litigation. As with other concepts of contract law, understanding them in advance can aid in preventative drafting to avoid disputes down the road.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Ambiguity

Even where a contract recites that it contains the complete understanding of the parties and disclaims the existence of any other written or oral agreements or understandings, the Parol Evidence Rule will allow a party to introduce evidence outside of the contract to resolve an “ambiguity.”

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Ambiguity

An ambiguity is a term to which reasonable persons might assign different, to the extent possible, contracts should be drafted to avoid ambiguities by assigning clear definitions to important terms, precisely describing the obligations of each party and carefully avoiding grammatical and word choice errors.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Ambiguity

In practice, contracts are rarely free from all ambiguity, and, in any dispute, ambiguities are often among the first points of attack of any good lawyer.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Interpretation

Parol evidence may also be permitted by a court to “interpret” a contract in order to determine the parties’ actual intent, but it will be permitted only to explain missing terms, not to contradict terms clearly provided for in the contract. The “Rules of Interpretation” discussion below goes into more detail on when and how courts decide whether parol evidence, also called “extrinsic” evidence, should be considered to better understand the parties’ intent.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Mistake

Parol evidence can also be introduced to show the absence of mutual assent necessary for the creation of a contract in the first place. To qualify under the exception and to invalidate a contract, a mistake must be “held by both parties” – i.e., both parties were mistaken about a fact material to the formation of the contract.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Mistake

A common example cited in text books is where party A agrees to pay party B a certain amount to drill a well to supply fresh water. After drilling at the place identified by A, B encounters impenetrable rock 20 feet down. Since both parties were mistaken about the feasibility of drilling the well, a court might nullify the contract on grounds of mistake.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Mistake

A mistake in business judgment or mistake of fact by one party, however, will not nullify a contract. For example, if one party gets a great deal on a rare coin because the other party did not know its value, he or she cannot later seek to invalidate the transaction. That is not what is meant by the term mistake in contract law. flag warranting guidance from counsel.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Fraud, Duress

Like mistake, proof that a party entered into a contract under duress or in circumstances involving fraud by the other party is permitted as an exception to the Parol Evidence Rule in order to show the absence of voluntary mutual assent.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Fraud, Duress

As one somewhat familiar example, a party stuck in a resort timeshare contract that has not turned out to be what the timeshare company represented might be able to invalidate the contract based on any documented fraudulent statements about things such as the likelihood of price appreciation, whether the timeshare contract was freely transferable, or even the degree to which the time share purchaser would enjoy booking priority over non-purchasing vacationers.

The Parol Evidence Rule

Expectations to the Parol Evidence Rule

Fraud, Duress

Similarly, an elderly person pressured into a timeshare contract following hours of high pressure sales tactics, including actions that made it difficult for the person to leave the sales presentation, might have a case for breaking the agreement due to claims of duress.

Lecture Two



Promise versus Condition

Promise versus Condition

Promise versus Condition

PROMISE VERSUS CONDITION

Under older case law, each party's consideration in a contract takes the form of a promise(s) or condition(s). This distinction is less important under modern case law, but awareness of the issue helps to highlight the need for detailing the consequences of either party's potential performance failures.

Promise versus Condition

PROMISE VERSUS CONDITION

Here are excerpted definitions of these terms from Black's Law Dictionary:

Promise

A declaration, verbal or written, made by one person to another for a good or valuable consideration in the nature of a covenant by which the promisor binds himself to do or forbear some act, and gives to the promisee a legal right to demand and enforce a fulfillment.

Promise versus Condition

PROMISE VERSUS CONDITION

Here are excerpted definitions of these terms from Black's Law Dictionary:

Condition

A future and uncertain event upon the happening of which is made to depend the existence of an obligation, or that which subordinates the existence of liability under a contract to a certain future event.

Promise versus Condition

PROMISE VERSUS CONDITION

Failure by “party A” to perform on its promise(s) will always allow “party B” to seek damages from party A, but may or may not enable party B to withhold its performance.

Absent clear language, a court will try to ascertain the “intent of the parties.” This requires reading the contract as a whole and, if necessary, considering any evidence available to it under exceptions to the Parol Evidence Rule. The court may conclude that the promise not performed by party A does not excuse party B’s performance, but merely creates a right in party B to pursue damages.

Promise versus Condition

PROMISE VERSUS CONDITION

Under modern case law in most jurisdictions, however, if party A's breach is material, party B's performance will be excused and B would also likely be entitled to damages.

When a contract clearly states that party A's performance is a condition to party B's obligation to perform, then party B will be excused from performing if party A fails to perform.

Lecture Two



Rules of Interpretation

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Rules of Interpretation

Intent of the Parties

Most contract disputes involve questions of interpretation. Disputes can arise from different views of the same language or different ideas on how to deal with unanticipated gaps in the contract language. The goal of contract law is to determine what the parties intended at the time they entered into the agreement. This is done first and foremost by examining the contract language, and then, as necessary, the factual context.

Rules of Interpretation

Rules of Interpretation

Intent of the Parties

Drafting to minimize issues of interpretation is often challenging for non-lawyers. This is because of the inherent subtleties of written language and the non-lawyer's inexperience in dealing with contract disputes, litigation, judges, juries and other aspects of law that are learned only by lawyering.

Rules of Interpretation

Rules of Interpretation

With that caveat, here are some generally accepted rules of interpretation:

Plain Meaning. Words are given their plain and normal meaning, except where the usage of a particular word has varied that meaning.

Technical Words. Technical words, or words customary to a particular industry, will be given their technical or special meanings when used in that context.

Rules of Interpretation

Intentions of the parties

Words will be given the meaning that seems to best reflect the intentions of the parties.

Consistency with General Purposes. Every part of a contract will be read in a manner that is consistent with its general purposes.

Surrounding Circumstances. As described above under the Parol Evidence Rule, the circumstances surrounding a contract's negotiation may sometimes be shown to aid in its interpretation.

Rules of Interpretation

Intentions of the parties

Words will be given the meaning that seems to best reflect the intentions of the parties.

Narrow or Restricted Meanings. Specific uses of a term or phrase in a contract may impose the same narrow or restricted meaning upon more general uses of the same term or phrase in a contract.

Lists. Depending on the context and specific language used, detailed lists of similar items can be read to exclude items that are not similar. Conversely, a general list can be read to include more than those listed.

Rules of Interpretation

Intentions of the parties

Words will be given the meaning that seems to best reflect the intentions of the parties.

Reasonableness. Where possible, a contract will be interpreted to render it reasonable rather than unreasonable.

Non-Drafting Party Bias. Given competing meanings, a court will generally favor the one urged by the non-drafting party.

Rules of Interpretation

Intentions of the parties

Courts use these rules to standardize how language will be interpreted in the event of a dispute. The goal is always to determine and give effect to the “intent of the parties.”

First and foremost then, parties to an agreement should attempt to summarize their intentions. As discussed below in Chapter Five, Common Contract Terms, the intent of the parties can be explained in the “recitals” or “whereas” clauses at the top of the agreement.

Rules of Interpretation

Intentions of the parties

Other drafting tips for clarifying the intent of the parties:

Avoid words, clauses, or sentences that may have more than one meaning. This includes being sensitive to the different outcomes that the use of “and” can have when “or” is the better choice and visa versa.

Place adverbs, adjectives, and other modifiers with precision and use appropriate grammatical techniques and punctuation to achieve clarity.

Rules of Interpretation

Intentions of the parties

Other drafting tips for clarifying the intent of the parties:

Lastly, use terms consistently. Contract drafting is not the same as creative writing – avoid using a variety of terms to express the same meanings and using variety of terms to express many meanings. Contracts need to be clear, not interesting.

Lecture Two



Implied Covenant of Good Faith and Fair Dealing

FAITH and FAIR DEALING
IMPLIED COVENANT OF GOOD

Implied Covenant of Good Faith and Fair Dealing

IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

As noted above under Rules of Interpretation, between two competing interpretations of a contract provision, courts will often favor the one that renders the provision reasonable rather than unreasonable.

This implied covenant generally requires the parties to act honestly and fairly with each other. Fraudulent, evasive, oppressive, dishonest or otherwise unfair conduct by one party against another has been deemed to violate the covenant.

Implied Covenant of Good Faith and Fair Dealing

Implied Covenant of Good Faith and Fair Dealing

Dispute Resolution, a party that can point to violations of specific contractual provisions supported by provable facts usually has the upper hand in a dispute. Barring such facts, however, if one party to an agreement has acted in a morally reprehensible manner that prevented the other party from receiving “the fruits of its bargain” or that “frustrates the overarching purpose of the agreement,” some states, like California, may allow a claim and damages based on a breach of the implied covenant of good faith.

Implied Covenant of Good Faith and Fair Dealing

Here are some examples where the covenant might be successfully invoked:

Intentionally withholding critical information from the other party.

Intentionally performing poorly in order to extract concessions from the other party, particularly if done by a party in a much more powerful position.

Failing to provide reasonable cooperation necessary for the other party's performance or otherwise interfering with or thwarting the other party's performance.

Implied Covenant of Good Faith and Fair Dealing

Here are some examples where the covenant might be successfully invoked:

Seeking to terminate an agreement based on false or highly exaggerated claims of breach by the other party.

Willful conduct intended to cause commercial harm to the other party.

Lecture Two



Waiver, Modification

Waiver, Modification

Tort Claims

Tort Claims

Dispute resolutions

Dispute Resolution, punitive damages and attorneys' fees, generally disallowed under contract law, can be awarded in "tort" claims – i.e., wrongful conduct that causes harm to others. Torts alleged in business include, among others, fraud, tortious interference with a contract, and theft of trade secrets.

It is somewhat common, for example, to see both breach of contract claims and the tort claim "fraud in the inducement," or simply "fraudulent inducement," in the same lawsuit. In such cases, the plaintiff is arguing both that the defendant breached the terms of the parties' agreement, but also that the parties' agreement should be entirely invalidated because the defendant induced the plaintiff to enter into the agreement by means of fraudulent statements.

Tort Claims

Tort Claims

Dispute resolutions

Additionally, tort claims alleging professional negligence against professional service providers are also often permitted in addition to or instead of contract claims against the same professional service provider.

Waiver, Modification

Waiver and Modification are two different but logically related concepts that both involve intentional or unintentional changes to the obligations of one or both parties to an agreement.

Sometimes a party will ask the other party for a waiver or modification during the course of performance as a result of a change in intentions or circumstances. Other times, once a dispute has arisen, issues of waiver or modification are raised as defenses to nonperformance.

Both highlight the need to avoid casually undermining or clouding the parties' original obligations to one another.

Waiver

Waiver, Modification

Waiver, Modification

Sometimes a party's performance will vary from or fall short of what is required under a contract. If the other party expressly accepts the lesser performance without complaining, despite having time and opportunity to do so, that party may later be deemed to have “waived” its ability under the contract to complain and seek full performance, a refund, or damages.

As an example, if party A has long accepted party B's delivery of inventory items on the 15th of each month without complaint despite the contract's requirement that delivery occur on the 1st of each month, a court might reject party A's sudden claim of breach, based on party B's argument that Party A “waived” the requirement of timely delivery.

Modification

Waiver, Modification

Waiver, Modification

The concept of modification is similar to waiver in that parties to a contract may later agree to changes, either orally or in writing. Any modification, often captioned in writing as an “Amendment” or “Addendum,” should be handled with the same care as the original contract. When handled by non lawyers, modifications are often made orally or by other informal means. In larger organizations, employees should be cautioned to avoid saying or doing things without proper authorization that could be interpreted by others outside of the organization as modifying important contractual requirements negotiated by others in the organization.

Modification

Waiver, Modification

Waiver, Modification

Waiver and modification issues can result in costly “he-said, she-said” battles. This is an area of contract law where dispute avoidance requires attention during both contract drafting and implementation.



thank
you!