

# Guide to Texas Law



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## Texas Contract Law

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## Contract Law

A contract is a legally binding agreement between parties to do or not do something. Businesses enter into contracts for many reasons, including purchasing supplies, insuring employers or entering into buy/sell agreements. A businessperson should have a good understanding of contract law, therefore, to succeed in business. As an initial matter, there are several factors to consider to determine whether a contract has been made. Once a contract has been created, it must be determined if there are any issues that call into question its validity. Finally, if there has been a breach of the contract, there is a question of whether damages have occurred.

This chapter summarizes the elements of a contract, who can enter into contracts on behalf of a company, factors that may affect validity of a contract, and recovering damages if a contract is breached. One should always read and understand a document before signing it. Before a businessperson enters

into a contract with major implications, he or she should consult an attorney experienced in the subject matter of the contract.

## Contract Components

There are three elements that must be present for a contract to exist: offer, acceptance, and consideration.

### Offer

The first step to a contract is an offer. An offer is a written or spoken statement by a party of his or her intention to be held to a commitment upon acceptance of the offer. Many business owners have become involved in legal disputes because, during negotiations, a customer believed an offer had been made when the businessperson believed the parties only were discussing possible options. A businessperson should carefully consider whether his or her statements or the statements of other parties constitute offers. There are a number of factors to look at to determine whether a statement constitutes an offer.

- Is the person making the offer serious? A business executive who jokingly suggests the sale of a successful business in exchange for a good bottle of scotch is not making an offer. On the other hand, a business executive who writes up an offer on a bar napkin may be perfectly serious. A court will look at the context in which the statement was made to determine whether it was a valid offer.
- Does the statement show a willingness of the party to be held to its contents? A person requesting a price quote or opening negotiations is not making an offer. An advertisement usually is viewed as an invitation to an offer rather than an offer itself.
- Does the statement contain definite terms? If the subject matter is identified, the parties are identified, the price is set, quantities are determined, and a time is set for performance, an offer very likely has been made. There should be enough information contained in the statement that, if needed, a court would be able to enforce the contract or determine the damages.

### Acceptance

The second requirement for a valid contract is acceptance of the offer. In order for an acceptance of an offer to be effective, it must be made while the offer is still open. In some

situations, the company making the offer gives a definite time frame: "My company will sell you this computer software for \$2000, but you must decide whether to buy it within two days." Other ways an offer may end include: the person making the offer withdraws the offer, the person who receives the offer rejects it, a reasonable amount of time passes after the offer is made, or the subject matter of the offer is destroyed before acceptance.

Unless an offer specifies otherwise, an offer can be accepted though the mail. An important rule known as the "**mailbox rule**" says that an acceptance is effective once it is put in the mailbox. If the offeror attempts to withdraw the offer after the acceptance is mailed but before it is received, the person accepting the offer can hold the offeror to the contract. For this reason, anyone making an offer should be aware that it might be accepted, by means of the mailbox rule, before the offeror knows of the acceptance. This can cause problems for the offeror if he or she assumed the offer was rejected and found another buyer. To avoid possible confusion, some businesses will specify in an offer that acceptance of the offer is only effective upon receipt of the acceptance.

If a person changes the conditions of an offer in responding to the offer, the offer is rejected and the changed conditions constitute a counter-offer: "I want to buy the software, but I will pay only \$1500 for it." In this scenario, the person who made the original offer can respond to the counter-offer by accepting or rejecting it, or proposing yet another offer.

There are two ways a person can accept an offer: by promising to do something, or by performing the desired act. In the first type, known as a bilateral contract, a customer accepts an offer to sell computer software by promising to pay \$2000 for the software. In the second type, known as a unilateral contract, a business owner offers a contractor \$1000 to replace ceiling tiles and the contractor replaces the tiles; the contractor accepted the offer by performing the act requested.

## **Consideration**

Consideration is a legal concept that describes something of value given in exchange for a performance or a promise of performance. The presence of consideration distinguishes contracts from gifts. Consideration can be a promise to do something there is no legal obligation to do, or a promise to not do something there is a legal right to do. Promises to exchange money, goods, or services are forms of consideration. All parties in an agreement must give consideration in order to create a contract, but courts typically do not make a determination about the adequacy of the

consideration unless there is evidence of some type of wrongdoing by the party benefiting most from the contract.

## **Defenses to Contract**

Once it is determined that the basic elements of a contract exist, it must be determined whether there are any defenses that call into question the validity of the contract. There are some defenses that make the contract automatically unenforceable (void) and other defenses that give the parties the option not to enforce the contract (voidable).

### **Legality of the Contract**

Although two persons may exchange an offer, acceptance, and consideration, if the subject matter of the contract is illegal, a valid, enforceable contract does not exist. For example, if a person offers to pay another person money for illegal drugs, and an acceptance is made by the promise to deliver the illegal drugs, this is nevertheless a void contract.

### **Capacity of the Parties**

In order to be bound to a contract, the parties must be competent to enter into the legal arrangement. Underage persons, persons who are mentally ill, and intoxicated persons usually are not bound by the contracts they enter. However, a minor may have the option of enforcing a contract under some circumstances.

### **Agency**

A business may challenge the validity of a contract by alleging that the person who signed the contract for the company was not an agent of the company and therefore had no authority to act on the company's behalf. Agency is a legal status--one party, the agent, has authority to conduct business for another party, the principal. Unless they have very small businesses, most business owners must rely on other people to conduct business and enter into contracts on behalf of their businesses. Thus, agency is a common aspect of doing business. Because principals are bound by contracts entered into by their agents, business operators should be familiar with the laws of agency.

An agent's authority to enter into contracts on behalf of the business can be actual, implied, or apparent. Actual authority is authority that the principal has intentionally given to an agent who has accepted it. The clearest example of creating actual authority is when a business owner hires someone to

negotiate purchases for the company. Implied authority may result from the agent's relationship with the principal or the principal's business, from custom, or by acquiescence. For example, a principal might not intentionally authorize an employee to make credit purchases for the business, but if the principal repeatedly pays debts incurred by the employee, he or she may inadvertently create implied authority in that employee. Apparent authority results when the principal acts in a way that causes third parties reasonably to assume that the agent has authority. For example, if a business owner is aware that an employee is claiming authority to act on behalf of the business, the principal should clarify that the employee is not authorized to enter into a contract on behalf of the business, or the employee's apparent authority may bind the business.

### **Mistake, Duress, and Fraud**

A mutual mistake—a **mistake** by both parties to a contract on an important issue--makes the contract unenforceable. However, a mistake by only one party does not necessarily make the contract void. A contract is not necessarily unenforceable because one party has made a miscalculation or wrong assumption.

**Duress** is the use of force or pressure by one party to make the other party agree to the contract. The force does not have to be physical--it may be mental pressure. The use of duress makes the contract voidable by the party under duress.

**Fraud** is the intentional misrepresentation of an important issue of the contract. The presence of fraud in a contractual proceeding makes the contract voidable by the party upon whom the fraud was perpetrated.

### **Statute of Frauds**

Contracts, in many instances, do not have to be in writing to be legally binding. However, a rule known as the Statute of Frauds requires that some contracts must be written to be valid. Under Texas law, contracts involving the sale of real estate, contracts concerning the sale of goods worth more than \$500, contracts that cannot be performed within one year, contracts to pay off someone else's debts, and marriage contracts must be in writing.

### **Parol Evidence Rule**

Although it is not a defense to a contract, the parol evidence rule may affect the contents of a contract and how a contract is enforced. The parol evidence rule applies once parties have

come to a final, written contract. Once there is a final, written contract between the parties, the parol evidence rule forbids the introduction in a court proceeding of any previous agreements between the parties on the subject matter of the contract. The parol evidence rule permits the judge or jury in a contract dispute to look only at the written contract and not at any previous discussions between the parties. The reasoning behind the parol evidence rule is that all factors that are important to the agreement and that have been decided by the parties should be stated in the final, written contract. The parol evidence rule does not, however, forbid the introduction of subsequent agreements between the parties.

## **Contract Termination**

Once there is a valid contract between parties, it can end in several ways. A contract with a stated, limited time span simply expires at the end of the stated time. If a person is hired to work for two weeks, the contract concludes at the end of two weeks. In many instances in which there is a specific time frame stated in the contract, parties to the contract may have the option to extend the contract for a longer period of time.

Contracts also may be project specific. A contract may be made for the provision of goods for a project, and upon the completion of the project the contract for these goods or services ends. Parties to a contract may mutually agree to rescind the contract. In that case, the parties may agree on the duties and responsibilities of each party after the rescission.

A contract also may end because of a breach. A breach occurs when a party does not fulfill his or her responsibilities under the contract. A breach may be minor or major. A minor breach is one that affects small, minor details of the agreement and may not affect the outcome of the contract. However, a major breach is one that does affect the subject matter of the contract and may affect the outcome of the contract. This is also known as a material breach. When there has been a breach of a contract, the question of damages is raised.

## **Damages**

The type and amount of damages due to a party when there is a contract breach depend on many factors, including which party breached the contract, what damages were incurred, what the contract states with regard to damages, whether the breach was material, and the subject matter of the contract. When a person is harmed by a breach, courts usually award only foreseeable damages. Foreseeable damages are those

damages that the parties anticipated or should have anticipated at the time the contract was formed.

### **Money Damages**

In most cases of an injury resulting from a breach of contract, the injured party receives money damages. The court awards the amount of money needed to place the person in the position he or she would have been in if the contract had not been breached. For example, suppose a business owner contracts with a roofer to put a new roof on a warehouse but the roofer stops in the middle of the job and refuses to finish the new roof. If the business owner finds another roofer to finish the job at an additional cost of \$15,000, the damages are \$15,000.

Although a person normally is entitled to the money difference between what was promised and what it costs to complete the promise, the injured party must try to "mitigate" the damages. **Mitigation** means the injured party takes reasonable steps to limit the extent of the injury and finish the job. In the previous example, the business owner must make reasonable efforts to find another party to finish the roof and must take reasonable steps to protect inventory in the warehouse from exposure due to the lack of a roof. If the business owner refuses to look for another roofer and consequently inventory in the warehouse is ruined, the breaching roofer will probably be able to successfully defend against paying for the cost of the ruined goods.

### **Specific Performance**

There are some situations in which money damages are inadequate. Typically, awarding money damages for a breach of contract involving the sale of land does not put the injured party in the same position he or she would have been in if the contract had been fulfilled. Because real estate is unique, one cannot simply go out and buy different property to replace the property for which one originally contracted. In a case such as this, the court may order the breaching party to perform the duties required by the contract. This remedy is called specific performance. Specific performance is ordered by courts only in rare cases in which the subject matter of the contract is unique, making it difficult to put a monetary amount on the damage incurred as a result of the breach. Specific performance is not awarded in personal service contracts. In the previous example, the court would not order the original roofer to complete the job.

## Liquidated Damages

In an attempt to set a monetary damage amount in a case in which it may be difficult, the parties may include a provision that specifies the amount of damages in event of a breach. Such predetermined damages are called liquidated damages. For example, a company may put down "earnest money" for space in a mall and agree in the real estate contract to forfeit the earnest money to the mall owners as a damage award in the event of a breach. If the business owner decides not to open the store, the earnest money will be awarded as liquidated damages.

## Rescission

In most contract disputes, a court puts the nonbreaching party in the position he or she would have been in if the contract had not been breached. However, there are times when the court may place the party in the position he or she was in before the contract was executed. This remedy is known as rescission. Rescission may be selected in cases in which one party intentionally misrepresents a material fact, for example. If a party has delivered goods or money to another party who fails to perform his or her duties under the contract, the court may decide simply to order that the goods or money be returned. The nonbreaching party then is in a position to contract with someone else.

## **Mandatory Arbitration and Forum Selection**

Parties to a contract often agree in advance to arbitrate any disputes arising under the contract rather than going to court. Arbitration agreements usually specify that each party chooses an arbitrator and the two arbitrators choose a third. Mandatory arbitration can save time and money, but a business owner may want to have an attorney review the mandatory arbitration clause before signing a contract that includes one.