CHAPTER 8: GENUINE AGREEMENT

GENUINE AGREEMENT AND RESCISSION

- A valid offer and valid acceptance generally results in an enforceable contract.

- If one of the parties used physical threats to acquire the other person’s signature on a contract, then there isn’t really a genuine agreement.

- genuine agreement (genuine assent or mutual assent) exists when consent is not clouded by fraud, misrepresentation, duress, undue influence, or mistake.

- If genuine agreement is missing, the victim may cancel or disaffirm the contract because the contract is voidable.

- voidable contract contract in which the injured party can withdraw, thus canceling the contract.

- rescission backing out of the transaction by asking for the return of what you gave and offering to give back what you received.

  - to be effective, it must occur shortly after you discover that there is no genuine agreement.

  - it must occur before you ratify the contract.

- ratification acting toward the contract as though one intends to be bound by it.

A. DURESS

- Occurs when one party uses an improper threat or act to obtain an expression of agreement.

- The contract is voidable.
1. **Threats of Illegal Conduct**

- **Examples:** a crime or a tort

- **Examples:** committing an act of violence → stabbing
  threatening a crime → threatening to stab
  committing a tort → unlawful detention
  threatening a tort to obtain a signature on a written contract

- Threats can be against the victim, the victim’s immediate family, the victim’s near relatives, liberty, or property of the victim.

2. **Threats to Report Crimes**

- If you see a crime, you have a duty to report it to the proper authorities.

- **coercion** → threat of force or an act of violence.

- **Example:** If you use a threat of reporting the crime to coerce the criminal to contract with you. This could also be **extortion**.

3. **Threats to Sue**

- The law encourages parties to try and settle disputes before taking it to court.

- Sometimes a party might tell the other party that they will sue if they don’t settle.

- If you threaten to sue for a purpose that is unrelated to the lawsuit, then it is duress.

4. **Economic Threats**

- **Example:** If a manufacturer has a contract to pay a supplier $15 for a special computer part needed to maintain production, the supplier might threaten to withhold the parts unless the manufacturer agrees to a price of $20 each. If a disruption in the flow of parts would cause substantial injury to the manufacturer, then the courts would find the agreement on the new price and economic threat voidable for duress.
With economic duress cases, the courts look at both the threat and the alternatives available to the threatened party.

Duress exists if the threatened party had no choice but to enter into or modify a contract.

WHAT IS UNDUE INFLUENCE?

undue influence→when one party overpowers the free will of the other, taking unfair advantage to get the other to make a contract that is unfavorable.

Two key elements in undue influence are:
1. the relationship
2. the wrongful or unfair persuasion

When a contract occurs because of undue influence, the contract is voidable by the victim.

A. THE RELATIONSHIP

A relationship of trust, confidence, or authority must exist between the parties to the contract.

It is presumed to exist with contracts between attorney and client, husband and wife, parent and child, guardian and ward, physician and patient, or minister and congregation member.

B. UNFAIR PERSUASION

Example: unfair terms of the contract

Example: an elderly person, who is dependent on one child for daily care, may sell her home to that child for half its value. This is a strong evidence of lack of free will.

To avoid unfair persuasion, the stronger party should act with scrupulous honesty, fully disclose all important facts, and insist that the weaker party obtain a lawyer before entering into a contract.

Persuasion or nagging do not necessarily mean undue influence exists.
WHAT IS A UNILATERAL MISTAKE?

- **unilateral mistake** occurs when one party holds an incorrect belief about the facts related to a contract.

  - generally, this does not affect the validity of the contract.

- **Example**: a mistake from failure to read a contract before signing it

- **Example**: a misunderstanding from a rushed or careless reading of contract

- **Example**: signing a contract written in language you don’t understand will bind you even if you are mistaken about some of the contract’s content.

A. **RECOGNIZED UNILATERAL MISTAKE**

  - If the unilateral mistake is a major one, and the other party to the contract is aware of the mistake, a court may grant rescission to the injured party.

B. **INDUCED UNILATERAL MISTAKE**

  - The contract is voidable if one party has encouraged or induced the other to make the mistake.

  - **Example**: you are looking at a tray of diamonds and you choose the only stone on the tray that was a zirconium and offered a high price for it. The mistake would have been encouraged by the mixing of the zirconium with many real diamonds. The contract would be voidable.

WHAT ARE MUTUAL MISTAKES?

- **mutual mistake (or bilateral mistake)** is when both parties are wrong about some important facts.

- **material facts** important facts that influence the parties’ decisions about a contract.
If a mutual mistake occurs, the contract is void.

**Example:** If both the buyer and the seller think that the property is 41 acres and they contract for the sale based on this belief, then learn later that it is only 28 acres. Their agreement is not binding.

**Example:** buying a parcel of land on 335 Norton Avenue and the other person thought you meant 335 Norton Road (both the avenue and the road exist)

### A. MISTAKE ABOUT THE SUBJECT MATTER

- Mutual mistakes may occur as to the **existence** of the subject matter.

**Example:** Steve lives in Kentucky and owns a camp and a motorboat in the Adirondacks. On November 30, Steve sells the motorboat to Tom. The motorboat had been destroyed in a fire on November 29 at the marine where it was being stored for the winter. Neither Steve nor Tom knew about the fire. There is no contract because of the mutual mistake as to the existence of the motorboat.

- The law treats a unilateral mistake about the identity of the subject matter of a transaction as a mutual mistake.

### B. MISTAKE OF LAW

- In some states, when the mutual mistake is about the applicable law, the contract is still valid.

**Example:** if both parties to a sale of land mistakenly believe that local zoning laws permit construction of duplexes on the lot, the contract would be valid though there was a mutual mistake. This is because all persons are presumed to know the law.

- In other states, unilateral mistakes generally have no effect upon the contractual rights of the parties.

- In other states, mutual mistakes create the right to rescind or void the contract.
WHAT IS MISREPRESENTATION?

- In many contract negotiations, the parties make statements that turn out to be untrue.

- **innocent misrepresentation** → a party to a contract does not know that a statement he or she made is untrue.
  
  → the contract is voidable.

- **Example**: When selling a car, the seller might say that the car has 70,000 miles on it when it actually has 150,000 miles. The seller didn’t know the true mileage because a prior owner replaced the odometer.

- **fraudulent misrepresentation** → a party to a contract knows that a statement he or she made is untrue.
  
  → the contract is voidable.

- **Example**: The seller of a car knew that the car had 150,000 miles on it, but told the buyer it had 50,000 miles.

- Statements are treated as misrepresentations only if:
  
  1. the untrue statement is one of **fact** or there is **active concealment**, and
  2. the statement is **material** to the transaction or is fraudulent, and
  3. the victim **reasonably** relied on the statement.

A. **UNTRUE STATEMENT OF FACT**

- In misrepresentation, the statement must be one of fact rather than opinion.

- The statement must be about a **past** or **existing** fact.

- Any statements mentioned in regards to the future are opinions.

- When **experts** express an opinion, the law will treat the statement as a statement of fact.
1. **Active Concealment**

- Is a substitute for a false statement of fact.
- **Example:** When a seller of a house paints the ceiling to cover stains which indicates the roof leaks.

2. **Silence**

- In many situations, the seller may remain silent about defects.
- There are three situations where disclosure is required:
  1. Where a statement about a material fact omits important information. Half-truths cannot be used to conceal or mislead.
  2. When a true statement is made false by subsequent events. **Example:** when the seller says that the roof doesn’t leak, and latter on that night it really does leak
  3. When one party knows the other party has made a basic mistaken assumption. **Example:** a buyer may assume that a foundation is solid, but the seller knows of a defect allowing water to flood the basement each spring.

B. **MATERIALITY**

- There are three ways an untrue statement can be determined to be material:

  1. **A statement is material if the statement would cause a reasonable person to contract.**

     - **Example:** statements about the total number of miles on a car and the number of miles since the engine was rebuilt.
     - **Example:** a statement that a star’s signature on a baseball card is his authentic autograph, when in fact it is a forgery, is a statement that would be material to a reasonable person.
2. A statement can be material if the defendant knew this plaintiff would rely on the statement.

- **Example:** If a seller says the oil in the car was changed every 3,000 miles when it was only changed every 4,000 miles is a slight discrepancy. This slight discrepancy would probably not be material to a reasonable person. HOWEVER, if a buyer says that the frequency of oil changes is very important to her, then the statements about the frequency of oil changes would be material.

3. If the defendant knew the statement was false, this makes the statement material.

- If a seller lies about an otherwise nonmaterial fact, this is material.

- **Example:** If a seller says “I always had the truck serviced at the local Ford dealership,” when in fact he had it serviced at the local gas station.

C. REASONABLE RELIANCE

- Even though the statement is material, there is no misrepresentation unless the victim reasonably relied on it.

- **Example:** A buyer may be told by a diamond expert that the stone is perfect, but then learns from an appraiser that it is not. If the buyer still completes the sale, the buyer isn’t relying upon the statement.

FRAUD AND REMEDIES FOR FRAUD

- **fraud**

  - the deliberate misrepresentation or concealment of a material fact.

- All the elements of misrepresentation (**untrue statement of fact, materiality, reasonable reliance**) must be proven or there is no fraud.

- Misrepresentation, intent, and injury must be proven to show fraud.

- If a victim can show fraud, the courts will grant the victim assistance beyond rescission.
A. **Misrepresentation Must Be Intentional or Reckless**

- Fraud clearly exists when a person deliberately lies or conceals a material fact.

- Fraud exists if a person recklessly makes a false statement of fact, without knowing whether it is true or false.

- To constitute fraud, in addition to intending to deceive, the misrepresentation must also be intended to induce the victim to contract.

B. **The Misrepresentation or Concealment Must Injure**

- To establish fraud, there must be proof of injury.

- Intentional misrepresentation, but no injury → no fraud.

- If no injury, then you can’t sue for damages.

- No fraud if the wrongful concealment or misrepresentation did not affect the buyer’s decision to enter into a contract.

  - **Example:** Greg is looking at an antique motorcycle and the seller says it is “a 1938 Indian”. The seller knows it is really a 1937 Indian, but intentionally lies thinking that the new motorcycle is more valuable. Greg buys it for $9,000 and later finds out it is worth $14,000. Greg hasn’t suffered an injury. He could rescind based on misrepresentation, but he couldn’t establish fraud.

C. **Remedies for Fraud**

- If a seller innocently misrepresents a material fact, the buyer may rescind.

- Rescission is also available for fraud.

- If a victim can establish fraud, then the courts will also allow recovery of **compensatory (money) damages** and **punitive damages**.
1. **Rescission**

- Contracts entered into as a result of misrepresentation or fraud are voidable **BY** the injured party.
- Rescission returns the parties to the position they were in before the contract was made, with no damages.
- The injured or deceived party who has performed part of a contract may recover what has been paid or given.
- The injured or deceived party who has done nothing, may cancel the contract with no further obligations.
- If the injured or deceived party is sued, he or she can plead fraud or misrepresentation as their defense.

2. **Damages**

- If fraud is proven, then damages are available.
- The defrauded party may choose to ratify the agreement instead of rescinding it.
- If the contract is ratified, then either party may enforce it.
- The defrauded party who ratified may seek damages for the loss created by the fraud.
- Under the UCC, damages are available for the sale of goods (tangible personal property).

3. **Punitive Damages**

- If fraud is proven, then punitive damages are available.
- They are used to punish the party who committed the fraud.
<table>
<thead>
<tr>
<th><strong>Grounds for Avoiding Contract</strong></th>
<th><strong>Elements</strong></th>
<th><strong>Remedies</strong></th>
</tr>
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</table>
| Misrepresentation                 | 1. Untrue statement of fact  
  *or*  
  active concealment  
  *or*  
  silence when disclosure is required  
  2. Materiality  
  3. Reasonable reliance | Rescission  
  {And for “sale of goods”→damages} |
| Fraud                            | 1. Untrue statement of fact  
  *or*  
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  *or*  
  silence when disclosure is required  
  2. Materiality  
  3. Reasonable reliance  
  4. **Intent to deceive**  
  *or*  
  reckless statements intended to induce victim to contract  
  5. Injury | Rescission,  
  Compensatory (Money)  
  Damages,  
  Punitive Damages |