

SANCTITY OF CONTRACT: PROMISE KEEPERS AND PROMISE BREAKERS

Written contracts are essential! Many contracts are not enforceable unless they are in writing. Examples of these are: (1) the sale of goods (gasoline is a “good”) for over \$500, (2) the sale of real property, and (3) the lease of qualifying property for one year or longer.

There continues to be a growing number of disputes and questions about rights and obligations under contracts. That’s even more of a reason to have things clearly and completely spelled out in writing. Also, competition for customers is more intense, the deals out there are more complicated, and the stakes are high. Petroleum marketers need to know (or be reminded) of the basic rules of the contract game. You may be thinking, “I don’t need to know this stuff, that’s why I have a lawyer.” That’s not good enough unless your lawyer also runs your business.

Think about it; your business is defined by contractual relationships. You have contracts with your suppliers, with your customers, with your bankers, probably with your key employees, and the list goes on and on. Each of those contracts gives you certain rights and imposes upon you certain obligations. Once those contracts are in place, the success of your business, in large part, depends on whether you get what you bargained for under the contracts and whether you are able to perform the obligations you have undertaken.

Why Are Contracts Important?

A “contract” is the way society formalizes the expectations of parties through the exchange of legally binding promises. Although contracts are not unique to Western civilization, our present system dates back to the development of English common law. As a result, society has established a comprehensive system of rules to ensure the realization of reasonable expectations induced by promises. This set of rules is known as the “Law of Contracts.” Fundamental to a well-ordered society is a judicial system to provide a rational, nonviolent process through which obligations are enforced and rights upheld. Contrast this to methods used in Medieval Europe or the Wild West. The bottom line of all this is that society recognizes the legitimate interests of contracting parties to obtain the benefit of the bargain made, and courts (which are creations of society) are firmly committed to protecting these interests.

Sanctity of Contract

The reason why contracts are valued so highly in our society is tied into the whole notion of private property rights, and rights created under a contract are property rights. Oral contracts have given way to written contracts due to the increasing complexity of our commercial relationships and decline in ethical business conduct.

There are two contrasting views on the value placed on contracts. One view, referred to as the “sanctity of contract” position, places an extremely high value on the promises set forth in a contract. (This is the view of the “promise keepers.”) Persons who hold this view believe it is tantamount to unethical or immoral behavior for a party to breach a contract without justification. The competing view believes that contracts, like many rules, are made to be broken. (This is the view of the “promise breakers.”) All of us have known people that fall in both camps. Between

these two opposing views there is, of course, a middle ground. Justice Oliver Wendell Holmes best described this middle ground as the “bad man theory of contract law.” According to Justice Holmes, our system of law does not make breaching a contract a crime or otherwise subject the breaching party to sanctions for unethical or immoral conduct. Rather, people are free to breach their contracts with impunity as long as they are prepared to suffer the consequences, which is standing liable to the nonbreaching party for monetary damages caused by the breach. You won’t be thrown in jail or ostracized from society for breaching a contract. There is no such thing in the law as a willful breach or malicious breach of contract. You either honor the contract or you don’t. (An exception to this, however, is the rule that you cannot enter into a contract, that is make a promise which you never intend to perform; that’s fraud; and in certain cases, a person committing this type of fraud can be slapped with punitive damages.) In other words, you can break your contract as long as you’re willing to run the risk that the other party will sue you to enforce your obligation and receive the benefit of the bargain expected.

There is a change in business ethics prevalent in today’s marketplace. Absolute promises, like absolute truths, have given way to the “everything’s relative to what is going on now” view. As a result, changes in circumstances are increasingly seen as reasons to vary from otherwise valid contractual obligations. Is this okay? As a general rule of law, it is probably not. Again, it’s okay to want out of a deal that has gone bad, but unless the other party has done something to turn the deal sour, you face the logical consequences described by Justice Holmes. It cannot be overemphasized that there are few exceptions under the Law of Contracts which will excuse or relieve a person from performing obligations established by contract. The following reasons are not recognized excuses:

- \$ I made a bad deal. The law will not relieve a person for being out-negotiated or for stupidity. A person might go to businessmen’s hell for a stretch, but the person is stuck with the bargain made.
- \$ How did this happen? The law won’t let someone out of a contract because things didn’t turn out as planned. A mistake by one party about a fact (unilateral mistake of fact) is not an excuse either.
- \$ Things changed. Generally, changes in circumstances will not let a person off the contractual hook. Regardless of whether there is more competition, prices have gone through the roof or what have you, the law generally requires a person to perform or pay.
- \$ Financial hardship. Merely because a deal had not turned out to be as financially advantageous as planned or that it resulted in a financial hardship are not valid excuses to terminate a contract. (An exception to this general rule will be discussed below under “Frustration of Performance.”)
- \$ A better deal. And the all-time favorite excuse—“I can get a better deal.” This may very well be a valid reason for wanting out of a contract, but it will not excuse a person from one.

The above list is only an example of excuses which will not pass the smell test under the Law of Contracts. There are, however, certain circumstances which will excuse or relieve a person from performing under a contract.

- \$ Impossibility. This is difficult to prove, and it means what it says. Merely because performing a contract is difficult or even impractical does not meet the test. An example of “impossibility” is a change in the law which makes the performance of the contract illegal. Another example is where the standard by which contractual performance is measured is changed or eliminated.

- \$ Frustration of Performance. This is a close second to “impossibility.” An example of “frustration” as a grounds for excusing performance is where an act of God intervenes to prevent performance, such as the burning down of a factory so goods cannot be manufactured and shipped as promised. Another example of frustration is where the conduct of a party “frustrates” the other party from performing. For example, if a person is supposed to sell 100,000 gallons of gasoline per month, that person’s performance is prevented if the supplier jacks up the wholesale price to noncompetitive levels. Another way of saying this is that the one party’s failure to perform has been caused by the other party’s actions.

- \$ Unconscionability. This is where one party has significantly more leverage and bargaining power than the other, and as a result, forces “unconscionable” contract obligations upon the weaker party. These are also known as contracts of adhesion. Proving unconscionability in the commercial world is difficult. Under Florida law, economic duress is not a generally recognized excuse.

- \$ Mutual mistake of fact. A mutual mistake of fact, as opposed to a unilateral mistake, can excuse a person from performing. In order to be mutual, each of the contracting parties must be mistaken as to the true state of things. The difference between a mutual mistake and a unilateral mistake is that in the former, neither party understands the subject matter of the contract. While in the latter case, only one party is mistaken. (See how many mutual mistakes of fact you can think of in 60 seconds, beginning now.)

- \$ Breach by the other party. This is by far the most recognized and safest ground for excusing performance. It’s only common sense that if one party refuses or fails to perform a material (i.e., important) part of the contract, the other party should be let out of the deal.

Now that you have taken a quick tour through Contracts 101, the ultimate question still remains--what if I’ve made a bad deal and want out?

- \$ Bite your lower lip. Sometimes, circumstances change which make a good deal a bad deal. Unless the deal is truly a stinker, one alternative is to set your jaw and complete the contract, vowing not to make the same mistake again.

- \$ Walk away Renee. This is the bold (or foolish depending upon the eventual consequences) strategy of cutting your losses and hoping you're not sued. If so, perhaps you can drag the lawsuit out to wear the other side down so you can wind up suffering far less than if you had fully performed under the contract. This is a pretty risky strategy.

- \$ Buy your way out. Rather than walking away and challenging the other side to sue, you can negotiate a buyout arrangement based upon a simple cost/benefit analysis. If you have been presented with a better deal, you should know the likely financial difference between the better deal and the deal you're under. Put yourself in the other person's shoes in an effort to figure out what your deal with him is really worth. As a general proposition, there is a fairly small range of amounts that either you are willing to pay or the other side is willing to receive to end the contract. The challenge is to first discover through negotiations the high and low points in the range, and then negotiate the buyout amount as close to the lower end as possible. Like most negotiations, this takes time, patience and information.

By now you should get the picture—contracts, like marriages, are not to be entered into lightly or unadvisedly. This is especially true with long-term contracts. What looks like a great deal today can turn to garbage five years down the road.

A final word. If you take seriously your duty to perform your contractual obligations, you have a strong moral and legal right to expect others to perform their contractual obligations to you. Many of your contracts create valuable property rights for you. Make sure these contracts are well drafted—clearly spell out what is expected—and have teeth. An open-ended or ambiguous contract is an invitation to disaster, especially if you're dealing with a promise breaker. Contracts which are clear and have some teeth (i.e., attorneys' fees for enforcement) can deter the promise breakers from cheating or walking away. But if they do cheat or walk, a well-written contract is easier to enforce in court. As with other aspects of your life, the Golden Rule is hard to beat when contracts are involved.