Consideration

The concept of consideration distinguishes agreements that the law will enforce from gratuitous promises, which are normally unenforceable.

Elements of Consideration

- Consideration is legal value, bargained for and given in exchange for an act or promise.
  - A promise generally cannot be enforced against the person who made it unless the person to whom the promise was made has given up something of legal value in exchange for the promise.
- Thorne vs Deas, p. 144
- The consideration requirement tends to limit the scope of a promisor’s liability for his promises.
- The mechanical application of the consideration requirement often produced unfair results.
- The relative importance of consideration in modern contract law has been somewhat eroded by numerous exceptions and judicial applications of consideration principles to produce fair results.

Legal Value

- The promisee does or agrees to do something he had no prior legal duty to do.
  - or,
- The promisee refrains from doing or agrees not to do something he has a legal right to do.
  - Hamer v. Sidway, p. 145
Adequacy of Consideration

- Courts generally do not look at whether the consideration was adequate to the promise given.
- Courts generally don't want to second guess the bargaining decisions of the parties. Freedom to contract = freedom to make bad bargains. Ensures Certainty, predictability.
- Courts generally don't look at real-world value
  - Exception: Inadequate consideration on face of agreement
    - e.g., $1,000 for $500, 20 biz law textbooks for 40 identical textbooks
    - May give rise to inference of reality of consent, capacity, legality issues
    - Courts may refuse to enforce disguised gratuitous or gift promises supported by nominal consideration.
      - e.g., $1 for car

Bargained for Exchange

- Just because something has legal value it is not necessarily consideration.
- Legal value must be bargained for and given in exchange for the promisor's promise to constitute consideration.
- The legal value must be the motive or inducement for the other party's promise or performance.

Exchanges That Fail to Meet Consideration Requirements

- Illusory promises
- Preexisting duties
- Forbearance to sue
- Past consideration
- Moral obligation
Illusory Promises

- An illusory promise is one that does not bind the promisor to do anything.
  - e.g.,
    - “I will buy all the sugar I want.”
    - “I will paint your house if I feel like it.”
- An illusory promise cannot serve as consideration.

Effect of Cancellation or Termination Clauses

- A cancellation or termination clause in a contract that can be exercised at any time for any reason renders illusory any promise by the party possessing the right.
- If clause requires notice or minimum time before cancellation, likely *meets* consideration requirement.
  - Examples:
    - “No cancellations within 90 days.”
    - 30-day notice requirement
  - If the exercise of the clause is conditioned on some act of the party it is not considered illusory.
    - e.g., Failure to live up to dealership obligations (franchise)

Effect of Output or Requirements Contracts

- **Output contract** - obligates one party to buy all of the output (goods) of the other party.
  - e.g., “I’ll buy all you can make.”
- **Requirements contract** - obligates one party to buy all of its requirements (goods) from the other party.
  - e.g., “I’ll buy everything I need from you.”
- Common law courts often refused to enforce output or requirements contracts (old rule).
- The UCC legitimized output and requirements contracts, obligating both parties to act in **good faith**. So these contracts are not illusory; they are generally enforceable.
Effect of Exclusive Dealing Contracts

- An exclusive dealing contract gives the distributor (or dealer) the exclusive right to sell a manufacturer's products in a particular territory.
- The promises would be illusory if the dealer/distributor had no duty to sell or the manufacturer had no duty to supply.
- The UCC imposes a duty on a dealer/distributor to use her best efforts to sell goods and a reciprocal duty on the manufacturer to use her best efforts to supply the goods (good faith).

Preexisting Duties

- As a general rule, performing or agreeing to perform a preexisting duty is not consideration.
  - e.g., Existing contract to mow lawn for $10 with Bob. Mowing the lawn can't be consideration in a new contract, even if new contract is with a third party, like Bob's wife.

Preexisting Public Duties

- Not committing a crime does not constitute consideration.
  - e.g., Tony Soprano tells someone, “Pay me $100/month and your dry cleaning business won't burn down”
- Performance of his public responsibilities by a public official is not consideration.
  - Examples:
    - Paying a police officer, $50/month to walk by your store on his beat, during his shift.
    - Rewards for capture of criminals
Preexisting Duty and Contract Modification

- Under the common law, an agreement to modify an existing contract requires some new consideration to be enforceable.
  - Exceptions:
    - Any new consideration, e.g., finishing early, adding something
    - The modification resulted from unforeseen circumstances that make a party’s performance far more difficult than originally anticipated.
    - If the modification agreement was fair and free from coercion, a court may find that the old agreement was terminated and a new one was created.

Preexisting Duty and Contract Modification: UCC

- Under the UCC, an agreement to modify a contract for the sale of goods requires no consideration to be enforceable.
- Contract modifications under the UCC are subject to the principles of good faith and unconscionability.
- Modifications must be in writing

Preexisting Duty and Agreements to Settle Debts

- Liquidated debt – a debt that is both due and certain.
  - General Rule: A creditor’s promise to discharge a liquidated debt for part payment at or after its due date is unenforceable for lack of consideration.
    - But see: Composition agreements, credit card settlement
- Unliquidated debt – there exists a good faith dispute about the existence or amount of the debt.
  - Accord and satisfaction – the settlement of an unliquidated debt.
Composition Agreements

- Composition agreement – an agreement between a debtor and two or more creditors who agree to accept a stated percentage of their liquidated claims as full payment of a debt currently due.
- Many states allow credit card debtors to settle debts at a discount with individual creditors.
  - e.g., Amex can “settle” with a cardholder for less that she owes.
  - Known as “settlement”
  - Must be signed by both parties
  - Also regulated by Fair Debt Collection Practices Act

Forbearance to Sue

- A promise to refrain from pursuing a legal claim can be valid consideration.
- The basis for settlement agreements
- Must be a good faith belief by promisee in the validity of the claim in order for forbearance to amount to consideration

Past Consideration

- Because it was not bargained for in exchange, past consideration is not valid consideration.
  - e.g., “In consideration for your good behavior as a minor, I will pay you $5,000”
  - Not consideration; a gratuitous promise.
  - Compare: Hamer v. Sidway
Moral Obligation

- Promises made to satisfy a preexisting obligation are generally unenforceable.
  - e.g., Food and lodging, emergency care
- However, some states may enforce certain types of moral obligation promises
  - Some states require promise to be in writing

Exceptions to the Consideration Requirement

- Courts sometimes enforce a promise without consideration.
  - Promissory estoppel.
  - Promises to pay debts barred by statute of limitations.
  - Promises to pay debts barred by bankruptcy discharge.

Promissory Estoppel

- A promise that the promisor should expect to induce reliance (foreseeable reliance).
- Reliance on the promise by the promisee.
- Injustice to the promisee if the promise is not enforced.
- Used as a consideration substitute in cases of donative promises and commercial promises contemplating a bargained-for exchange.
  - Examples:
    - UCLA Hospital relies on pledge of $25 million, begins planning and construction
    - Contractor relies on bid of subcontractor when submitting general bid
Promises to Pay Debts Barred by Statute of Limitations

- **Statute of limitation** – a statutory time limit on a person's ability to pursue a legal action
- Contracts SOL's can run from 2-10 years
- A creditor must file an action to collect an unpaid debt within the statutory time period.
  - Debt collections are breach of contract cases
  - Fast-tracked in California courts
- Most states allow creditors to collect debts where statute has run so long as the promise to pay is in writing.

Promises to Pay Debts Barred by Bankruptcy Discharge

- Once discharged within a bankruptcy proceeding, a debt may not be collected by a creditor.
- Not all debts dischargeable in bankruptcy
  - Taxes
  - Child/spousal support
  - Student loans (unless proof of undue hardship)
- Within statutory restrictions, a debtor's reaffirmation of such debts are enforceable.
- Requires court approval, right to revoke promise within 30-days, promise must be made prior to discharge