

CONTRACTS: A QUICK INTRODUCTION OR REFRESHER

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Contracts form the foundation of business, employment, real estate, and countless other legal relationships. As paralegals, understanding contract formation, enforceability, and potential breaches is essential to assisting attorneys and clients effectively. A valid contract requires offer, acceptance, consideration, capacity, and legality. We'll explore these elements and discuss key issues such as breach of contract, remedies, and the importance of clear drafting to avoid disputes. Additionally, we'll cover how paralegals contribute to contract review, compliance, and litigation support. At the end of this presentation, attendees will be able to:

1. Identify the elements required for contract formation including the topics of offer, acceptance, consideration, legality, capacity, consent, and when a writing is required.
2. Identify basic defenses to contracts including fraud, misrepresentation, and mistake.
3. Identify extracontractual remedies including promissory estoppel and quasi-contract.

I. Some Definitions to Get Us Started¹

A **Contract** is a legally enforceable agreement.

For a contract to be enforceable, seven key characteristics must be present.

- **Offer:** Someone proposes a deal.
- **Acceptance:** To accept, the party must respond in a certain way.
- **Consideration:** There must be an exchange between them.
- **Legality:** The contract must be for a lawful purpose.
- **Capacity:** The parties must be adults of sound mind.
- **Consent:** Certain kinds of trickery and force can prevent the formation of a contract.
- **Writing:** Some kinds of contracts must be in writing.

Bilateral contract: A promise made in exchange for another promise.

Unilateral contract: One party makes a promise that the other party can accept only by actually *doing* something.

Executory contract: An agreement in which one or more parties has not yet fulfilled its obligations.

Executed Contract: An agreement in which all parties have fulfilled their obligations.

Valid contract: one that satisfies all legal requirements.

Unenforceable agreement: occurs when the parties intend to form a contract, but a court declares that some rule of law prevents enforcing it.

Voidable contract: An agreement that may be terminated by one of the parties.

Void agreement: A contract that neither party can enforce, because the bargain is illegal or one of the parties had no legal authority to make it.

Express contract: An agreement with all the important terms explicitly stated.

Implied contract: The words and conduct of the parties indicate that they intended an agreement.

II. A Quick Note

This presentation will focus on the basic "common law" principles of contracts. It will not cover contract requirements under the Uniform Commercial Code, including Article 2 of the UCC.

¹ The contents of this handout are taken from: Beatty/Samuelson, Business Law and the Legal Environment, 8th ed., Cengage Publishing, 2019 and additional materials related to the textbook. This is a great textbook, and anyone interested in an introduction to law would benefit from reading this text.

III. Offer

Offer: An act or statement that proposes definite terms and permits the other party to create a contract by accepting those terms.

Not Offers: Invitations to Bargain, Price Quotes, Letters of Intent, and Advertisements (amongst others)

For Offers to be accepted, the offer must be “definite” enough to be able to understand what has been excepted. For example, price and quantity are usually terms that must be defined.

Offers can be terminated by:

- *Revocation*-The offering party letting the other party know the offer is no longer available.
- *Rejection*- Rejection may be clearly stated, and immediately terminates the offer. A counteroffer also terminates the original offer.
- *Expiration*- An offeror may set a time limit on an offer; if she does not, the offer expires after a “reasonable time.”
- *Operation of Law*-An offer terminates if the offeror dies or becomes mentally incapacitated, or if the subject matter of the offer is destroyed.

IV. Acceptance

Acceptance: An act or behavior that indicates the unqualified agreement to the terms of an offer

Mirror Image Rule: Requires that acceptance be on precisely the same terms as the offer.

Method and Manner of Acceptance: The “method” refers to whether acceptance is done in person or by mail, telephone, email, or fax. The “manner” refers to whether the offeree accepts by promising, by making a down payment, by performing, and so forth. **If an offer demands acceptance in a particular method or manner, the offeree must follow those requirements. If the offer does not specify a type of acceptance, the offeree may accept in any reasonable manner and method.** **Mailbox Rule:** Acceptance is generally effective upon dispatch. Terminations are effective when received.

V. Consideration

Consideration: The inducement, price, or promise that causes a person to enter into a contract and forms the basis for the parties’ exchange.

Act: Any action that a party was not legally required to take in the first place.

Forbearance: Refraining from doing something that one has a legal right to do.

Bargained for: When something is sought by the promisor and given by the promisee in exchange for their promises. What is not consideration? When a party has a preexisting duty to do something or if the party has already completed what they are to do under the contract. **Preexisting Duty:** If someone provides a service that she is already obligated to do, that act is not consideration. (Exception: Additional Work, Modification, Unforeseen Circumstances). **Past**

Consideration: A completed act cannot be the basis for consideration.

VI. Legality

For contracts to be valid, they must comply with the law.

Common legality concerns for contracts include:

- *Impermissible Wagers*: Such as gambling contracts or even insurance contracts if the insured does not have an insurable interest in the insured property
- *Licensing Statutes*: When a licensing requirement is designed to protect the public, any contract made by an unlicensed worker is unenforceable. When a licensing requirement is designed merely to raise revenue, a contract made by an unlicensed person is generally enforceable.
- *Usury*: Usury laws prohibit charging excess interest on loans.
- *Contracts That Violate Public Policy*: A judge may declare a contract void even if it does not violate a statute. For example, contracts that promote immorality or illegality are unenforceable.
- *Exculpatory Clauses*: **Exculpatory clause**: A contract provision that attempts to release one party from liability in the event the other is injured. A contract cannot contain an exculpatory clause that is too broad.

Unconscionable Contracts: An unconscionable contract is one that a court refuses to enforce because of fundamental unfairness. Even if a contract does not violate any specific statute or public policy, it may still be void if it “shocks the conscience” of the court.

- **Procedural Unconscionability**: One party uses its superior power to force a contract on the weaker party.
- **Substantive Unconscionability**: A contract with extremely one-sided and unfair terms.
- **Adhesion contracts**: Standard form contracts prepared by one party and presented to the other on a “take it or leave it” basis.

VII. Capacity

Capacity is the legal ability to enter into a contract.

Parties that Lack Capacity To Enter Into Contracts

- *Minors*: In contract law, a minor is someone under the age of 18.
- *Mentally Impaired Person*: A person suffers from a mental impairment if by reason of mental illness or defect she is unable to understand the nature and consequences of the transaction.
- *Intoxicated/Impaired Individuals*: When one party is so intoxicated that he cannot understand the nature and consequences of the transaction, the contract is voidable. But courts are *highly skeptical* of intoxication arguments.

Disaffirm: To give notice of refusal to be bound by an agreement.

Rescind: To cancel a contract.

Restitution: Restoring an injured party to its original position.

Ratification: Words or actions indicating an intention to be bound by a contract.

VIII. Consent

Consent refers to whether a contracting party truly understood the terms of the contract and whether she made the agreement voluntarily. Lack of valid consent can arise when the following are present:

1. Fraud
2. Mistake
3. Duress, and
4. Undue Influence

Fraud begins when a party to a contract represents something that is factually wrong. An injured person must show the following:

1. The defendant knew that the statement was false, or that he made the statement recklessly and without knowledge of whether it was false;
2. The false statement was material; and
3. The injured party justifiably relied on the statement.

If all elements of fraud are present except the misrepresentation of fact was not made intentionally or recklessly, then **innocent misrepresentation** has occurred. So, if a person misstates a material fact but with good reason to believe the statement true, most states allow rescission of a contract, but not damages.

The distinction between misrepresentation and fraud lies in intent. Misrepresentation can occur innocently, without awareness of a statement's falsity. If the defendant knows a statement of fact is false, or is uncertain whether it is true and intends that the other party rely on the statement, then there is fraud.

Mistake: occurs when at least of the parties makes a mistaken assumption about the contract.

Unilateral mistake: Occurs when only one party enters a contract under a mistaken assumption.

Mutual mistake: Occurs when both contracting parties share the same mistake.

Depending on the type of mistake, a party may or may not be able to rescind the contract

- To rescind for unilateral mistake, the mistaken party must demonstrate that he entered into the contract because of a basic factual error and that:
 - The nonmistaken party knew or had reason to know of the error, or
 - The mistake is mathematical or mechanical alone, or
 - Enforcing the contract would be unconscionable
- If the contract is based on a fundamental factual error by both parties, the contract is voidable by either one. But courts will not rescind contracts on the basis of:
 - Prediction error
 - Mistake of value
 - Conscious uncertainty

Duress: An improper threat made to force another party to enter into a contract. If one party makes an improper threat that causes the victim to enter into a contract, and the victim had no reasonable alternative, the contract is voidable. In most states today, economic duress can also be used to void a contract. In analyzing a claim of economic duress, courts look at these factors:

- Acts that have no legitimate business purpose
- Greatly unequal bargaining power
- An unnaturally large gain to one party
- Financial distress to one party.

To prove **undue influence**, the injured party must demonstrate:

- A relationship between the two parties either of trust or of domination, and
- Improper persuasion by the stronger party.

IX. Writing

The **Statute of Frauds**: A plaintiff may not enforce any of the following agreements, unless the agreement, or some memorandum of it, is in writing and signed by the defendant. The agreements that must be in writing are those:

- For any interest in **land**
- That **cannot be performed within one year**
- To pay the **debt of another**
- Made by an **executor of an estate to pay the debt of the estate**;
- Made **in consideration of marriage**; and
- For the **sale of goods worth \$500 or more**.

But, once a contract is fully executed, it makes no difference that it was unwritten.

What Is a "Writing"? The writing may be a carefully typed contract, using precise legal terminology, or an informal memo scrawled on the back of a paper napkin at a business lunch. The writing may consist of more than one document, written at different times, with each document making a piece of the puzzle. But there are some general requirements: the writing:

- Must be signed by the defendant, and
- Must state with reasonable certainty the name of each party, the subject matter of the agreement, and all of the essential terms and promises.

X. Performance

Discharge: A party is discharged when she has no more duties under the contract.

Rescind: To terminate a contract by mutual agreement.

If a party is discharged, she is "finished" and has no more duties under a contract. Most contracts are discharged by full performance. In other words, the parties generally do what they promise. Sometimes the parties discharge a contract by agreement.

Strict Performance: Requires one party to perform its obligations precisely, with no deviation from the contract terms.

Substantial Performance: Occurs when one party fulfills enough of its contract obligations to warrant payment.

In a contract for services, a party that substantially performs its obligations will generally receive the full contract price, minus the value of any defects. When is a performance substantial? There is no perfect test, but courts look at these issues:

- How much benefit has the promisee received?
- If it is a construction contract, can the owner use the thing for its intended purpose?
- Can the promisee be compensated with money damages for any defects?
- Did the promisor act in good faith?

A **Material Breach** occurs when a party fails to at least substantially perform. When one party materially breaches a contract, the other party is discharged. The discharged party has no obligation to perform and may sue for damages.

Anticipatory Breach occurs when one party making it unmistakably clear that he will not honor the contract.

Some defenses to performance include:

- **Impossibility:** If performing a contract was truly impossible, a court will discharge the agreement. But if honoring the deal merely imposed a financial burden, the law will generally enforce the contract. True impossibility means that something has happened making it literally impossible to do what the promisor said he would do. This is generally limited to three causes:
 - destruction of subject matter,
 - death of the promisor in a personal services contract, and
 - Illegality.
- **Commercial Impracticability:** means some event has occurred that neither party anticipated and fulfilling the contract would now be extraordinarily difficult and unfair to one party.
- **Frustration of purpose:** means some event has occurred that neither party anticipated and the contract now has no value for one party.
- Courts consider the following factors in deciding impracticability and frustration claims:
 - Mere financial difficulties will never suffice to discharge a contract.
 - The event must have been truly unexpected.
 - If the promisor must use a different means to accomplish her task, at a greatly increased cost, she probably does have a valid claim of impracticability.
 - A force majeure clause is significant but not necessarily dispositive.

XI. Damages

When a party fails to perform their contract duties, the Court can award the non-breaching party damages. The first step that a court takes in choosing a remedy is to decide what interest it is trying to protect. An **interest** is a legal right in something. There are four principal contract interests that a court may seek to protect:

- **Expectation interest.** This interest is what the injured party reasonably thought she would get from the contract. The goal is to put her in the position she would have been in if both parties had fully performed their obligations. Courts typically divide the expectation damages into three parts: (1) direct (or “compensatory”) damages, which represent harm that flowed directly from the contract’s breach; (2) consequential (or “special”) damages, which represent harm caused by the injured party’s unique situation; and (3) incidental damages, which are minor costs such as storing or returning defective goods, advertising for alternative goods, and so forth.
- **Reliance interest.** Even if the injured party has not shown an expectation interest, he can still recover damages if he proves that he *spent money* in reliance on the agreement and that, in fairness, he should receive compensation.
- **Restitution interest.** The injured party may be unable to show an expectation interest or reliance. But perhaps she has conferred a benefit on the other party. Here, the objective is to restore to the injured party the benefit she has provided.
- **Equitable interest.** In some cases, money damages will not suffice to help the injured party. Something more is needed, such as an order to transfer property to the injured party (specific performance) or an order forcing one party to stop doing something (an injunction).

Mitigate: To keep damages as low as reasonable. A party injured by a breach of contract may not recover for damages that he could have avoided with reasonable efforts.

Nominal damages: A token sum, such as one dollar, given to a plaintiff who demonstrates a breach but no serious injury. Nominal damages provide plaintiff with a “moral victory.”

Liquidated damages: A clause stating in advance how much a party must pay if it breaches.

XII. Good Faith and Fair Dealing

The fundamental principle of all contract law is good faith and fair dealing. *Alta Vista Props., LLC v. Mauer Vision Ctr.*, 855 N.W.2d 722, 730 (Iowa 2014) citing Restatement (Second) of Contracts § 205, at 99 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

XIII. My Client Should At Least Get Something Even If There Isn't Technically A Contract

Promissory estoppel: A possible remedy for an injured plaintiff in a case with no valid contract, when the plaintiff can show a promise, reasonable reliance, and injustice. Even when there is no contract, a plaintiff may use promissory estoppel to enforce the defendant's promise if he can show that:

- The defendant made a promise knowing that the plaintiff would likely rely on it
- The plaintiff did rely on the promise
- The only way to avoid injustice is to enforce the promise.

Quasi-contract: A possible remedy for an injured plaintiff in a case with no valid contract, when the plaintiff can show benefit to the defendant, reasonable expectation of payment, and unjust enrichment. Even when there is no contract, a court may use quasi-contract to compensate a plaintiff who can show that:

- The plaintiff gave some benefit to the defendant
- The plaintiff reasonably expected to be paid for the benefit and the defendant knew this; and
- The defendant would be unjustly enriched if he did not pay
- **Quantum meruit:** "As much as he deserves" – the damages awarded in a quasi-contract case.

XIV. When Should A Contract Be In Writing

First, ask whether you need a written contract. Some cases work out well without a written contract, but there are times when you should definitely sign an agreement:

1. The Statute of Frauds requires it.
2. The deal is crucial to your life or the life of your business.
3. The terms are complex.
4. You do not have an ongoing relationship or trust with the other party.

XV. I Have A Contract, How Should I Go About Reading It

Reading a contract should be a focused, multi-step process where you ask yourself "what-if" questions and determine the answers to those questions:

- **Pre-reading:** Before you begin reading, ask what's important to you.
- **The first read:** read through to get the basic idea of the contract.
- **What-ifs:** Think about outcomes, good and bad. What happens if all goes according to your plan? Worst-case scenarios? Does the contract produce the result you want? What happens if...?
- **The second read:** Now, read to make sure the contract handles the what-ifs in a way that is satisfactory to you. Does it make sense?

XVI. Some Things To Include In Contracts To Protect Clients

Choice of law provisions: Determine which state’s laws will be used to interpret the contract.

Choice of forum provisions: Determine the state in which any litigation would take place.

Modification: Contracts should contain a provision governing modification.

Assignment of Rights and Delegation of Duties: An assignment of rights is a transfer of your benefits under a contract to another person. Delegation of duties is a transfer of your obligations under a contract. **Novation:** A three-way agreement in which the obligor transfers all rights and duties to a third party.

Arbitration: Some contracts prohibit the parties from suing in court, and require that disputes be settled by an arbitrator. Arbitration has its advantages – flexibility and savings in time and money. It also has downsides.

Attorney’s fees: As a general rule, if parties to a contract end up in litigation, they must pay their own legal fees, no matter who is in the wrong. But contracts may override this general rule and provide that the losing party in a dispute pays the attorney’s fees for both sides.

Integration: During contract negotiations, the parties may discuss many ideas that are not ultimately included in the final version. The point of an integration clause is to prevent either side from later claiming that the two parties had agreed to additional provisions.

Severability: If, for whatever reason, some part of the contract turns out to be unenforceable, a severability provision asks the court simply to delete the offending clause and enforce the rest of the contract.

Force Majeure: A force majeure event is a disruptive, unexpected occurrence for which neither party is to blame that prevents one or both parties from complying with the contract. Force majeure events typically include war, terrorist attack, fire, flood or general Act of God.

Notices: After a contract is signed, there may be times when the parties want to send each other official notices – of a breach, an objection, or an approval, for example. In this section, the parties list the addresses where these notices can be sent and when the notice is effective.

Closing: To indicate that the parties have agreed to the terms of the contract, they must sign it. When a party to the contract is signing on behalf of a business or a principal, they should be sure to indicate for whom they are signing, otherwise they may be personally liable on the contract.

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