Contract Formation and Enforcement in the United States: Overview

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Country Q&A | Law stated as at 01-Sep-2025 | United States

A Q&A guide to general contract formation and enforcement in the United States.

The Q&A gives a high-level overview of key requirements for a legally binding and enforceable contract. It includes general information on authority, capacity, and other legal requirements. The Q&A also considers contract enforcement and remedies, and choice of foreign law and jurisdiction.

Formation of Contracts

Authority and Capacity

1. What are the authority/capacity rules for entering contracts?

The following outlines the general rules regarding an individual's and entity's capacity to enter into contracts. There are many variations among the different US states.

Individuals

Individuals must be competent and past the age of majority to enter into a contract. A party's competence to enter into a contract is presumed.

Companies

Corporate powers, including the ability to enter into contracts, are exercised through the company's board of directors/managers or officers. Authorisation to enter into and execute contracts on behalf of a corporation or a limited liability company (LLC) is granted in the corporation's by-laws or board resolutions, or the LLC's operating agreement/LLC agreement. Directors or officers are generally authorised to perform the agreement.

Foreign Companies

Most US states require that a foreign entity (either non-US or from another US state) be authorised or qualified to do business in the state. For example, a foreign corporation seeking to do business in New York must file an application for authority with the Department of State, Division of Corporations before doing business in the state. Whether an entity is doing business in the state and therefore required to qualify can be a difficult factual issue. Sanctions for failure to qualify to do business include a fine and the inability to initiate a lawsuit in the jurisdiction's courts.

General Partnerships

Each partner is an agent of the partnership with the authority to bind the partnership to contracts in the ordinary course of the partnership's business. Each partner is also liable for each other partner's authorised contracts, and for the obligations of the partnership. The *Uniform Partnership Act (1997)* has been enacted in the majority of states.

Limited Liability Partnerships (LLPs)

Unlike for general partnerships, the partners in an LLP are not automatically agents of the partnership and therefore lack the authority to enter into contracts on behalf of the partnership, unless they have authority to do so under a principle of agency law. The LLP agreement should grant certain partners the authority to bind the partnership to contracts. If a partner attempts to bind the LLP while lacking agency power to do so, the LLP is not bound, but the partner may be liable for breaching the warranty of authority.

Trustees

Trustees have broad discretion to exercise the specific powers set out in the trust instrument and other reasonably necessary powers, including reasonable investment decisions. The trustees must exercise their powers in accordance with the terms of the trust and the trustees' fiduciary duties (Uniform Trust Code § 815).

Charities

The rules for charities are the same as for other entities. However, if a charity is to qualify for tax exempt status under federal tax law, it must avoid entering into contracts that provide private inurement and private benefit, and its contracts must be for the benefit of the charity and in accordance with the charity's mission.

Public Bodies and Local Authorities

Public bodies may be subject to additional statutory and regulatory requirements to enter into contracts. Those regulations may impose some limitations. For example, certain public bodies may be required to follow particular statutory or regulatory schemes governing the content of their contracts. Federal contracts (with the US Government) are heavily regulated and generally follow specific federal regulations. Municipal body contracts may also be heavily regulated. There is a lot of variation among agencies and jurisdictions.

Agencies

An agent's authority can be any of the following:

- **Actual (express).** This is where the principal expressly grants authority to the agent to act on the "principal's behalf." The grant can be oral, unless the contract itself must be in writing (see *Question 3*). Actual authority is revoked if the principal revokes it, dies, or becomes incapacitated.

- **Implied.** This is where the agent can take any actions reasonably necessary to perform an expressly authorised task, including actions customarily performed by individuals with the agent's title, and actions that the principal previously acquiesced to.
- **Apparent.** This is where a third party reasonably relies on an agent's appearance of authority.

For more information on agency rules, see *Practice Note, Key Agency Considerations: Overview (US)*.

Formal Legal Requirements

2. What are the essential requirements to create a legally enforceable contract?

A legally enforceable contract requires mutual assent (consisting of both offer and acceptance) and consideration. The courts generally use an objective measure to bind each party to the apparent intention a party manifested in dealings with the other party.

Offer and Invitation to Bargain

An offer is a communication that creates a reasonable expectation in the offeree that the offeror is willing to enter into the contract according to the offered terms. The offeror must express a definite promise, undertaking, or commitment to enter into the contract and must communicate the offer to the offeree. An offer is distinct from a mere invitation to deal, as the offer expresses the offeror's intent to enter into the proposed agreement. Language such as "I quote" or "I propose" is construed as an invitation to negotiate, while "I offer" or "I promise" indicates a firm commitment to enter into a contract. The relevant factors in determining whether the offer is a mere invitation to bargain or an offer include the following:

- Circumstances surrounding the offer.
- Prior relationship of the parties.
- Industry custom.

Advertisements addressed to the general public are generally considered as invitations to bargain, unless they are addressed to a specific offeree and contain definite terms. The terms of an offer must be certain enough to permit a court to enforce them as written (see *Restatement (Second) of Contracts* §§ 24, 26, 33).

An offer can be terminated by the offeror, the offeree, or by operation of law, as follows:

- **Termination by the offeror.** The offeror can revoke the offer before the offeree accepts it, through:

- direct communication;
- publication, if the offer was made by comparable means; or
- indirect communication, provided that the indirect communication is received from a reliable source and a reasonable person would infer that the offeror has terminated the offer.

The offeror cannot revoke the offer if the contract is an option contract for which the offeree has provided consideration to keep the option to enter the contract open for a specified period. The offer to enter into an option contract terminates if an acceptance has not been received within the specified option period.

- **Termination by the offeree.** An express rejection by the offeree terminates the offer. If the offeree makes a counteroffer containing the same subject matter as the original offer with different terms, the counteroffer is considered as a rejection and a new offer that the original offeror must accept.
- **Termination by operation of law.** The offer is terminated if either:
  - a party dies or is declared insane before acceptance, unless it is an option contract; or
  - the subject matter of the contract is destroyed or becomes illegal.

Acceptance

An acceptance is a manifestation of assent to the terms of the offer and must be unequivocal.

A battle of the forms scenario occurs when parties attempt to contract using communications that incorporate competing terms and conditions.

If the conflict is between merchants or relates to the sale of goods, the terms or conditions that are added by the offeree become a part of the contract unless:

- The new terms or conditions fundamentally or materially alter the terms of the offer.
- The offeror objects to the new terms and conditions within a reasonable time.
- The offer specifically limits the offeree's acceptance to the terms and conditions found in the offer.

However, no contract is formed if acceptance is expressly made conditional on assent to the additional or different terms.

Different rules apply if one or more parties is not a merchant or if the contract is not for the sale of goods. If the acceptance adds any terms, the added terms are considered proposals and are not a part of the final agreement, unless agreed to by the offeror.

See *Question 3* for a discussion on the formation of contracts through the conduct of the parties.

Consideration

Consideration is a bargained-for exchange between the parties which constitutes a benefit to the promisee or a detriment to the promisor. A legal detriment occurs when an individual does something with no legal obligation to do so. Although the courts do not inquire into the adequacy of consideration, past or moral consideration is generally insufficient. Additionally, a promise to perform a pre-existing legal duty is not sufficient consideration.

> 3. Which types of contracts, if any, must be in writing to be valid and enforceable? Under what circumstances are oral contracts valid and enforceable?

Writing Requirements

The following contracts must be in writing to be enforceable:

- A contract of an executor or administrator to answer for a duty of the individual's decedent.
- Suretyship promises to pay the debt of another, unless the promisor's main purpose is to serve its own pecuniary interest.
- Promises in consideration of marriage, including those that induce marriage by offering something of value.
- All contracts pertaining to an interest in land, including mortgages, fixtures, and easements and leases for more than one year or for which total payments due exceed USD1,000.
- All contracts including a promise that is impossible to perform within one year.
- Agreements that create a security interest in personal property if the property is not:
    - in the secured party's possession;
    - a certified security; or
    - collateral that consists of investment property, letter-of-credit rights, deposit accounts, or electronic chattel paper if the secured party has control over such collateral.
- Contracts for the sale of goods for USD500 or more, unless:
    - the goods are specially manufactured;

- a party admitted in court documents that a contract existed; or
- the goods have been delivered and accepted or paid for.

(*Statute of Frauds*.)

A writing is sufficient if it reasonably identifies a contract's subject matter, indicates that a contract has been made between the parties, and states with reasonable certainty the essential terms of the contract's promises to be performed (Restatement (Second) of Contracts § 131). The writing must therefore generally contain the material terms of the parties' agreement, namely:

- The identity of the parties.
- A description of the subject matter.
- Any terms necessary for the court to enforce the contract as written.

The Statute of Frauds does not require a formal written agreement. Receipts, letters, and invoices containing details of the transaction in the memorandum line often satisfy this requirement. Under the common law, a writing can consist of several writings rather than one single document, provided that the writings all relate to the same transaction, that they meet the above requirements when combined, and that at least one of the writings contains the signature of the party to be charged (Restatement (Second) of Contracts § 132).

A contract can be inferred from the conduct of the parties. If the parties behave as if they have reached a contract, and there is an unsigned written document that is proved to have been agreed by all parties, a court is likely to find the existence of a contract. This will depend on the facts and circumstances of the case.

Generally, contracts required to be in writing must be signed. The parties can use electronic signatures for most types of contracts and under most circumstances. For more information, see *Practice Note, Signature Requirements for an Enforceable Contract*.

Oral Agreements

Oral agreements are enforceable, with some exceptions (see above, *Writing Requirements*). However, where there is no written agreement, a court must often reconstruct the agreement and the parties' intent is the primary factor to consider. Broadly, the test for enforceability of an oral contract is:

- Both or all parties, having the power or capacity to contract, manifest objectively an intent to be bound.
- The essential terms of the agreement are agreed on and sufficiently definite to be enforced.
- There is consideration.
- The subject matter of the agreement and its performance are lawful.

Intent to be bound. The parties' objective intent, not their secret or subjective intent, is the relevant factor (see, for example, Conolly v. Clark, 457 F.3d 872 (8th Cir. 2006)). Courts consider what a reasonable person in the parties' positions would conclude given the totality of the circumstances. The "reasonable person" standard assumes individuals have an intention that corresponds with the reasonable meaning of their words and conduct, regardless of any unexpressed intent. Performance is often a key piece of evidence indicative of intent.

Essential or material terms. Courts consider whether the parties reached an agreement on all the terms that would be deemed "essential" or "material" to the contract. If the parties' agreement on an essential term is not sufficiently specific, courts will refuse to find an enforceable contract. What terms are essential to a given contract depends both on the intent of the parties and industry custom (even if one party is not aware of the custom). Generally, courts are reluctant to "fill in the gaps" for parties when it comes to essential terms, for fear of imposing unanticipated terms contrary to the parties' intent or expectations (Bus. & Comm. Litig. Fed. Cts.§ 148:11). In addition, if communications between the parties make it clear that a contract will not be formed absent a formal written agreement, and where the terms were never reduced to writing, a court will likely not find a contract between the parties, even where the parties orally agreed to all essential terms.

4. Are there language requirements for the validity of contracts? Is translation into the language of your jurisdiction required? If so, when is this required?

There is generally no English language requirement for contracts in the US, that is, no state requires a contract to be translated into English. However, some states, such as California, Texas, New York, Nevada, Washington, and Illinois, require that certain types of contracts negotiated in a language other than English must be provided in that language, unless an exception applies.

For example, California applies a translation requirement to consumer contracts. California law requires parties to a consumer contract that is negotiated primarily in Spanish, Chinese, Tagalog, Vietnamese, or Korean to provide the counterparty with a copy of the contract in the language used in negotiations (*California Civil Code § 1632*). The only exception to this requirement is when a professional interpreter is used to communicate between the parties. In all other instances, California law permits an aggrieved party to rescind the contract or agreement if the translation requirement is not complied with.

5. Are contracts in electronic form (email, web-based or otherwise) legally enforceable?

Contracts in electronic form can be legally enforceable. US federal and state statutes now make clear that electronic records such as email messages are an acceptable format for recording a contract. The federal *Electronic Signatures in Global and National Commerce Act* (E-SIGN) and the *Uniform Electronic Transactions Act* (UETA), a uniform statute adopted by every state (although in some cases with variations) except New York (which has its own *Electronic Signatures and Records Act* (ESRA)), provide that:

- A signature, contract, or other record relating to a transaction cannot be denied legal effect, validity, or enforceability solely because it is in an electronic format.
- A contract relating to a transaction cannot be denied legal effect, validity, or enforceability solely because it contains electronic signatures or other electronic records.

In most US states, including those that have adopted the UETA without significant variation on these points, the UETA provides as follows:

- A record or signature cannot be denied legal effect or enforceability solely because it is in electronic form.
- A contract cannot be denied legal effect or enforceability solely because an electronic record was used in its formation.
- If a law requires a record to be in writing, an electronic record satisfies the law.
- If a law requires a signature, an electronic signature satisfies the law.

A few states have not adopted the UETA to govern the enforceability of electronic signatures. Those states generally have instead adopted non-uniform legislation designed to achieve the goals of the federal legislation, E-SIGN.

However, even though these statutes provide that electronic transactions cannot be denied validity solely because of their electronic format, they do not validate electronic transactions that fail to otherwise conform with the applicable state statute of frauds.

Generally, there are no special evidentiary requirements when producing digital material in court. For example, in the State of New York, theESRA, codified as 9 NYCRR 540, provides that an electronic record used by a person has the same force and effect as those records not produced by electronic means (9 NYCRR § 540.5). Similarly, the use of an electronic signature as defined in ESRA has the same validity and effect as the use of a signature affixed by hand (9 NYCRR § 540.4).

New York courts have also held that "an electronically memorialized and subscribed contract [has] the same legal effect as a contract memorialized and subscribed on paper… [under] New York law" and that "e-mail will satisfy the statute of frauds so long as its contents and subscription meet all requirements of the governing statute" (Naldi v. Grunberg, 80 A.D.3d 1, 12 (1st Dep't 2010)).

For more information, see *Practice Note, Key Considerations in Electronic Communications: Contracts and Signatures*.

Preliminary Agreements and Pre-Contract Considerations

6. Which types of preliminary agreements are most frequently used and for which types of transactions? Are preliminary agreements presumed to be non-binding?

Preliminary agreements are entered into to guide the terms of discussions and engagement towards a definitive agreement. The most frequent preliminary agreement, entered into in almost all discussions, is a confidentiality or non-disclosure agreement. In many cases, some form of engagement letter is also entered into with adviser(s) who are assisting in a transaction. More complex transactions often also start with a letter of intent (LOI) or memorandum of understanding (MOU) (while simpler transactions often proceed directly to the negotiation and execution of definitive agreement(s)). For further information, see *Practice Note, Preliminary Agreements in Commercial Transactions*.

Confidentiality/Non-Disclosure Agreements

These legally binding agreements are entered into before transactions to preserve the confidentiality of discussions and information shared between the parties during the negotiation period. "Confidentiality" is often defined broadly and requires the parties, particularly the buyer, to keep certain information learned during the due diligence process strictly confidential. Confidentiality also often extends to the existence of discussions between the parties. Publicly available information is excluded from protection.

Confidentiality agreements are rarely disputed, although standstill provisions used to prevent hostile offers for public companies have generated litigation. These provisions prevent the buyer for a limited period from acquiring shares of the seller (see Ventas, Inc. v. Health Care Prop. Investors, Inc., 635 F. Supp. 2d 612 (W.D. Ky. 2009)). A confidentiality agreement is generally superseded by, or incorporated into, the acquisition agreement, or terminates after some years if no acquisition agreement is reached. The definitive agreement typically sets out the parties' agreement on the circumstances under which public disclosures of the transaction or its terms (or both) can be made.

Letters of Intent and Memorandums of Understanding

An LOI or MOU is typically a non-binding agreement that sets out the basic terms of a proposed transaction. It sets the terms for the negotiation of a definitive written agreement to be reached later. Except for specified terms (such as confidentiality, payment of expenses, or grant of an exclusivity or "no-shop" period or other "lock-in"), LOIs and MOUs are non-binding, although unclear language in LOIs has resulted in litigation. Parties should take care to both:

- Separate binding from non-binding provisions.
- Use explicit language to state that the non-binding provisions are non-binding.

Parties often only use the list of terms (a term sheet) where signing an LOI or MOU may give rise to disclosure or other duties, such as for public companies required to announce material developments. It is possible to have separate "lock-in" or "no-shop" agreements.

Engagement Letters

Before pursuing transactions, parties may enter into engagement letters with advisers. These agreements are generally legally binding. Engagement letters, from simple to complex, describe the services the adviser will perform and the compensation structure for the work, which include a success fee if the transaction is successfully concluded. Key terms include the definition

of the success fee and the transactions that trigger the requirement to pay the fee. Success fee terms often include a "tail" period extending after termination of the adviser's engagement, during which consummation of a transaction still triggers a success fee.

7. Are there limitations on the use of exclusivity or lock-out provisions in preliminary agreements under local law?

Generally, exclusivity provisions that restrict negotiation with third parties in preliminary agreements are enforceable if they are reasonable and do not violate antitrust laws. The restriction must be supported by consideration. The consideration given by a buyer in an exclusivity agreement generally consists in payment of a small sum to the seller or payment of fees, expenses, and costs for investigating the target and pursuing the acquisition.

Exclusivity provisions are generally agreed for a fixed period. The restriction period is set out in the agreement and usually depends on the parties and the size and complexity of the transaction. The parties often agree on a short period and then negotiate extensions if necessary. The seller must consider its fiduciary obligations when committing to work with only one buyer for a certain period, as well as applicable antitrust laws.

For more information, see *Practice Note, Exclusivity Agreements*.

8. What are the principles and rules (if any) on pre-contractual liability?

See *Question 9* for a discussion of when a party may incur pre-contractual liability by its action or inaction.

9. Can negotiations become legally binding in any circumstances?

General Rule

There is no general duty to act in good faith during preliminary negotiations. However, an LOI or MOU (see *Question 6*) may include an explicit or implicit requirement to negotiate in good faith.

Occasionally, a court may find that the parties intended to be bound by an LOI or MOU based on the "words and deeds of the parties," particularly where the parties refer to a written document as an "agreement," even as an "agreement in principle" (see Texaco, Inc. v. Pennzoil, Co., 729 S.W. 2d 768 (Tex. Ct. App. 1987) (superseded on other grounds); but see Rennick v. O.P.T.I.O.M. Care, Inc., 77 F.3d 309 (9th Cir. 1996) (referring to a document as a "letter of intent" implies, unless circumstances

suggest otherwise, that the parties intended it to be a non-binding expression in contemplation of a future contract, as opposed to it being a binding contract)).

Promissory Estoppel/Detrimental Reliance

If there is no enforceable contract between the parties, the doctrine of promissory estoppel may still make a promise binding and enforceable. This doctrine applies when all the following conditions are met:

- A promise is made by one party.
- The promise is of a type that the promisor would reasonably expect to induce the other party to act.
- That party acts in reliance on the promise to its detriment.

(Restatement (Second) of Contracts § 90.)

Promissory estoppel or detrimental reliance is more likely when the relationship involves a sophisticated player attempting to manipulate a less resourceful party.

10.Is the concept of "good faith" in negotiations recognised and applied? If so, how?

Section 1-304 of the *Uniform Commercial Code* (UCC), a uniform statute adopted by almost all states, although with variations, provides that "every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." Similarly, the Restatement (Second) of Contracts provides that "every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."

However, the duty of good faith and fair dealing that applies during the performance and enforcement of a contract does not extend to negotiations before the contract is formed (see *Question 9, General Rule*). Therefore, a failure to act in good faith during pre-contractual negotiations does not amount to a breach of contract. The required conduct at the negotiation stage is simply that each party is held to a degree of responsibility appropriate to the justifiable expectations of the other party (Williston on Contracts § 70:48).

However, certain forms of bad faith in contract negotiations may be subject to sanctions, such as violations of rules as to capacity to contract, fraud, and duress. Additionally, remedies for bad faith in contract negotiations can be found in the law of torts or restitution, or through a particular statutory duty to act in good faith. Where parties are negotiating modification of an existing contract, there are more specific rules requiring negotiation in good faith (see Restatement (Second) of Contracts §§ 73 and 89 and UCC §§ 2 to 209 (see Restatement (Second) § 205, cmt. c)).

The term "good faith" in the context of contracts generally means faithfulness to an agreed common purpose and consistency with the justified expectations of the other party. It excludes "bad faith" conduct violating community standards of decency, fairness, or reasonableness (see Restatement (Second) § 205, cmt. a). Section 1-201(19) of the UCC defines good faith as

"honesty in fact in the conduct or transaction concerned," and in the case of a merchant party, section 2-103(1)(b) defines it as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

For further information on the duty of good faith in commercial agreements, see *Practice Note, Implied Duty of Good Faith and Fair Dealing*.

Formalities for Execution

Contract Interpretation

11. Can contract terms be implied from the conduct of the parties or incorporated by reference?

A contract term, or an entire contract, can be implied through the parties' conduct and surrounding circumstances (Williston on Contracts §§ 1:5, 3:2). However, the material terms of the bargain must still be sufficiently definite to create a binding contract.

A contract implied in fact is based on a meeting of minds, which, although not included in an express contract, may be inferred from conduct of parties showing, based on the surrounding circumstances, their tacit understanding (Hercules Inc. v. U.S., 516 U.S. 417 (1996)). In determining whether the conduct of the parties creates an implied contract, the relevant conduct is evaluated using the "reasonable person" standard. An implied-in-fact contract requires proof of the same elements needed to show an express contract (that is, mutual assent, offer and acceptance, consideration, legal capacity, and a lawful subject matter) (see *Question 2*).

Contract terms can also be incorporated by reference. One written instrument can explicitly incorporate another written instrument, but incorporation by reference can also be inferred from the context surrounding the execution of the writings. Absent indications of contrary intent, writings executed at the same time, by the same parties, for the same purpose, and in the course of the same transaction may be considered and construed together as one contract, even where they do not refer to each other through their terms (Coleman v. Mariner Health Care, Inc., 407 S.C. 346, *cert. denied*, 135 S. Ct. 477 (2014)).

12. Which mandatory terms and standards are implied into a contract by operation of law?

Generally, the existence of mandatory terms depends on the subject matter of the contract, the identities of the parties, and the jurisdiction.

Often, the laws governing the subject matter of the contract require specific terms. For example, all 50 states and the District of Columbia adopted comprehensive insurance regulatory regimes. Although the primary focus of state insurance regulation

has historically been the solvency of insurance companies, states also sometimes require that particular terms be included in certain types of insurance policies. Under these laws or regulations, the required terms are mandatory rules.

Some state consumer protection statutes require the inclusion of certain provisions, and the failure of a seller of consumer goods or services to include these provisions in its contracts can result in class action liability.

The identities of the parties to a contract may also trigger the existence of mandatory terms, especially if a party to the contract is the US Federal Government. All 51 jurisdictions have also adopted varying levels of guidance regarding mandatory contract terms with their respective state and local governments.

Additionally, all international treaties to which the US is a party must be complied with. In the US, treaties to which the US is a party generally hold the same authority as federal law and supersede state regulations.

The duty of good faith and fair dealing is implied in every contract (see *Question 10*). For example, under common law, standards of performance or certain warranties may be read into certain types of contracts such as construction contracts or leases. Under the UCC, which has been adopted in almost all states, certain provisions can be "read in" to a contract for the sale of goods or services.

13. Is the concept of "reasonable," "commercial," or "best" endeavours or efforts in contracts legally recognised?

These effort-related modifiers are commonly used in contracts. There is debate about the meaning of the different levels, and the law varies from state to state. It is generally thought that:

- Commercially reasonable efforts is the lowest standard, and is based on a cost-benefit approach.
- Reasonable efforts is a medium standard, based on a reasonable person or reasonable company standard.
- Best efforts, in some jurisdictions, may be interpreted to require an unlimited expenditure of funds.

The best efforts modifier is not used as much as the other qualifiers and is often qualified by reasonableness if used. Certain contractual requirements are expected to be unqualified, such as an obligation to deliver under normal circumstances, while others are routinely qualified efforts, such as complying with a schedule that is challenging or at least not easily achieved.

For more information, see *Practice Note, Efforts Provisions in Commercial Contracts: Best Efforts, Reasonable Efforts, and Commercially Reasonable Efforts*.

14. Does local law require any contract terms be given special notice to be effectively incorporated in a contract?

To disclaim the implied warranty of merchantability in a contract for the sale of goods, the contract must contain a "conspicuous" disclaimer that either:

- Expressly identifies "merchantability."
- Includes an expression stating that the goods are sold "as is" or "with all faults."

(UCC § 2-316.)

Most states use similar definitions of conspicuous, although not all states have interpreted the definitions the same way. Practitioners routinely put these disclaimers in capital letters or bold type.

Enforcement and Remedies

Invalid and Voidable Contracts

15. What makes a contract void, voidable, or invalid?

Invalidity

An invalid contract usually takes one of the following three forms:

- **Void contract.** A void contract is without any legal effect from the outset (for example, an agreement to commit an illegal act). It cannot be enforced by either party.
- **Voidable contract.** A voidable contract is one that either or both parties can elect to avoid (for example, by raising a defence that makes it voidable, such as incapacity to enter into the contract). Unless rescinded, a voidable contract imposes on the parties the same obligations as if it were not voidable.
- **Unenforceable contract.** An unenforceable contract is an agreement that is otherwise valid, but which may not be enforceable due to various defences extraneous to contract formation, such as a statute of limitations or the Statute of Frauds.

Misrepresentation

Misrepresentation can be either fraudulent or non-fraudulent. Fraudulent misrepresentation can make the contract voidable by the innocent party if that party justifiably relied on the misrepresentation (fraud in the inducement). Fraudulent misrepresentation may include concealment and non-disclosure. Non-fraudulent misrepresentation can make the contract voidable if the innocent party justifiably relied on the misrepresentation and the misrepresentation was material to the contract.

Mistake

Mistake does not generally prevent the formation of a contract. However, if there is a mutual mistake (that is, a mistaken assumption shared by both parties) regarding an existing fact relating to the agreement, the contract can be voidable by the adversely affected party if the following conditions are met:

- The mistaken facts concern a basic assumption of the contract (for example, the parties think that the contract is for the sale of a diamond, but it is actually a cubic zirconia).
- The mistake has a material effect on the exchange agreed upon (for example, the zirconia is worth a hundredth of the diamond).
- The party seeking avoidance did not assume the risk of the mistake.

Unilateral mistake is rarely a barrier to contract enforcement, except in the event of unethical behaviour by the non-mistaken party (for example, if the non-mistaken party knew or had reason to know of the mistake of the other party).

Duress

Duress by physical compulsion prevents the formation of a contract. In other words, the contract is void. This is a very rare situation. An example of this situation is when a party that is physically weaker and the physically stronger party grasps the weaker party's hand and compels the weaker party by force to write their name. (Restatement (Second) of Contracts § 174, cmt. b.)

Duress by threat can make the contract voidable by the innocent party. The contract can be voidable by the innocent party if the innocent party's manifestation of assent is induced by an improper threat by the other party that leaves the victim no reasonable alternative (Restatement (Second) of Contracts § 175). If the innocent party's manifestation of assent is induced by a third party, the contract is voidable by the victim unless the other party to the transaction in good faith and without reason to know of the duress either gives value or relies materially on the transaction.

Undue Influence

Undue influence can make the contract voidable by the innocent party. Undue influence is unfair persuasion of a party who is under the domination of the person exercising the persuasion or who by virtue of the relation between them is justified in assuming that the person will not act in a manner inconsistent with their welfare (Restatement (Second) of Contracts § 176). If the innocent party's manifestation of assent is induced by undue influence by the other party, the contract is voidable by the innocent party. However, if the innocent party's manifestation of assent is induced by a third party, the contract is voidable by the innocent party unless the other party to the transaction in good faith and without reason to know of the undue influence either gives value or relies materially on the transaction.

Restraint of Trade

Generally, a provision or clause that restrains trade can be unenforceable on grounds of public policy if the restraint is unreasonable. A promise is in restraint of trade if its performance would limit competition in any business or restrict the promisor in the exercise of a gainful occupation (Restatement (Second) of Contracts § 186). The courts look at the following factors to determine whether the restraint is unreasonable:

- Duration of the restraint.
- Geographical area the restraint covers.
- Scope of the restriction.

Illegality

Legislation may provide that a type of promise or contract is unenforceable or void either entirely or partially unless it complies with specified requirements. However, generally legislation does not provide that a term is unenforceable on grounds of public policy but allows the courts to determine whether to enforce the term. In this situation, courts weigh the interest of enforcing the promise against public policy. (Restatement (Second) of Contracts § 178.)

In conducting this analysis, the courts look at the following:

- Interest of enforcing the promise.
- Strength of the public policy involved.
- Relation of the term to that public policy.
- Any misconduct involved.

Courts are reluctant to frustrate a party's legitimate expectations unless there is a corresponding benefit to be gained in deterring the misconduct in question or avoiding an inappropriate use of the judicial process.

Discharging Contracts

16. On what basis can a party be discharged from performing its contractual obligations at law?

Breach of a promise by one party may or may not excuse the other party's duty to perform. Breach of the contract when performance is due only excuses the duty of counter-performance if the breach is material. A minor breach may suspend this duty but does not excuse it. Rather, the US courts either:

- Award damages to the non-breaching party.
- Mitigate the non-breaching party's promised performance to account for the breach.

A breach is material (and therefore excuses counter-performance) if the obligee does not receive the substantial benefit of their bargain as a result of failure to perform or defective performance. The non-breaching party can treat the contract as terminated and has an immediate right to all remedies for breach of the entire contract.

Anticipatory repudiation by one party excuses the other party's duty to perform. Anticipatory repudiation is a statement by the obligor to the obligee indicating that the obligor will commit a material breach or a voluntary affirmative act that renders the obligor unable or apparently unable to perform without such breach.

Mutual rescission is recognised, provided that there is an express agreement to rescind between the parties. The agreement to rescind is itself a binding contract supported by consideration, namely the giving up by each party of their right to counter-performance from the other. The reasons for entering into the agreement are immaterial to a court absent duress or fraud. Generally, for a contract to be effectively discharged by rescission, the duties must be executory on both sides at least to some extent.

Contractual risk allocation terms, such as force majeure clauses, are generally enforced. Force majeure clauses state that performance can be excused or delayed where non-performance is caused by unexpected acts beyond the reasonable control of the parties. For further details, see *Practice Note, Force Majeure Clauses: Key Issues*. Absent such a clause, the courts generally determine who bore the risk of loss (and therefore whether performance was excused) based on the terms of the agreement or "gap-filling" tools, such as statutory provisions, the UCC, or policy and interpretational doctrines (for example, equitable conversion).

If an agreement does not contain a force majeure clause, and the UCC is not applicable, the parties may have to rely on the common law doctrine of frustration, which is much harder to establish than force majeure. Frustration exists if the purpose of the contract has become valueless by reason of some supervening event that is not the fault of the party seeking discharge. If the purpose of a contract has been frustrated, many courts will discharge contractual duties, even though the performance of these duties is still possible, if the following conditions are met:

- There is some supervening act or event leading to the frustration (for example, the enactment of a law making the duty illegal).
- At the time of entering into the contract, the parties did not reasonably foresee the act or event occurring.
- The purpose of the contract has been completely or almost completely destroyed by the act or event.
- The purpose of the contract was realised by both parties at the time of making the contract.

As cases arising out of the COVID-19 pandemic have begun to work their way through the courts, it has become clear that courts continue to set a high bar for cases of frustration and are reluctant to excuse performance, even where performance is burdensome.

Impossibility/impracticability is a doctrine that is similar to frustration. A party's obligation to perform will be discharged if, after a contract is made, a party's performance is made impracticable without their fault by the occurrence of an event the non-occurrence of which was the basis assumption of the contract was made, unless the language or the circumstances indicate otherwise (Restatement (Second) of Contracts § 261). As with frustration, courts continue to set a high bar for impossibility/impracticability and are reluctant to excuse performance, even where performance is burdensome.

For more information, see *Practice Note, Impracticability, Impossibility, and Frustration of Purpose: Overview*.

A condition precedent is an act or event that, unless the condition is excused, must occur before a duty to perform a promise in an agreement arises. In other words, if a party's performance is subject to a condition precedent, the party does not have to perform unless the condition occurs or is waived.

A condition subsequent to an enforceable contract is a term of the contract under which the occurrence or non-occurrence of an event after the contract becomes binding on the party causes the contract to terminate the obligations of a party.

17. On what basis does a party have the right to terminate the contract?

Generally, the right to terminate a contract is addressed specifically in the contract itself. If the contract is silent on the parties' rights to terminate the contract, a breach must be material to entitle the non-breaching party to terminate the contract (see *Question 16*). Under US bankruptcy laws, the right to terminate a contract on a party's insolvency is generally unenforceable (void) as a matter of policy. Reasonable notice of termination is generally required if a contract is silent, unless this may cause material harm.

Contract Liability and Exclusion of Liability

18. What are the key rules on privity of contract and third-party rights?

The general rule is that a contract only confers rights and impose duties on the parties to the contract. However, there are two important exceptions:

- Contractual rights involving third-party beneficiaries.

- Contractual rights and duties that are transferred to third parties.

In the first situation, the original contract confers the rights and duties on the third party. In the second situation, the original contract does not confer any rights or obligations on the third party, but one of the parties subsequently seeks to transfer their rights or duties (or both) to a third party.

Intended third-party beneficiaries have contractual rights and can enforce those rights once those rights have vested. The general rule, for both creditors and donee beneficiaries, is that their rights vest when the beneficiary does any of the following:

- Manifests assent to the contract's promise in a manner invited or requested by the parties.
- Brings suit to enforce the contract's promise.
- Materially changes their position in justifiable reliance on the contract's promise.

Incidental third-party beneficiaries (that is, those that benefit from the contract, but that benefit is not the primary purpose of the contract) have no contractual rights.

Generally, all contractual rights and duties can be delegated to third parties as permitted by the contract, subject to some common law and statutory exceptions, depending on the law in the relevant jurisdiction. For further information, see *Practice Note, Assignability of Commercial Contracts*.

19. What are the main rules relating to excluding and limiting contractual liability?

Generally, any contract can include liability waivers for negligence resulting from the performance of the parties, which are enforceable between sophisticated parties and in the absence of a specific public policy against enforcement. However, most jurisdictions do not enforce clauses attempting to waive liability for gross negligence, recklessness, or wilful misconduct, although the definition of these terms is often unclear and varies by jurisdiction.

The enforcement of implied terms depends on the nature of the contract. Article 2 of the UCC applies as a set of default rules for the sale of goods. Unless the contract provides otherwise, or expressly exempts itself from the provisions of the UCC, the courts use the terms provided for in the UCC as supplemental terms to fill in gaps in the contract. Under the UCC, the quantity of goods term is the only absolutely required term; all other terms can be supplied by the UCC and enforced by the courts. While the implied warranties under the UCC can be disclaimed by contractual agreement, express warranties cannot be disclaimed. See *Question 12* for additional information on implied terms.

For further information on excluding and limiting liability, see *Practice Note, Enforceability of Liability Waivers: Overview*.

20. What are the main defences to breach of contract claims?

The following are defences to breach of contract claims:

- Failure to perform (see *Question 16*).
- Unclean hands.
- Laches/statute of limitations.
- Anticipatory repudiation (see *Question 16*).
- Lack of consideration (see *Question 2*).
- Lack of capacity (see *Question 1*).
- Breach of the duty of good faith and fair dealing (see *Question 9* and *Question 10*).
- Unconscionability
- Illegality (see *Question 15, Illegality*).
- Force majeure (see *Question 16*).
- Duress (see *Question 15, Duress*).
- Misrepresentation/fraud (see *Question 15, Misrepresentation*).
- Misunderstanding.
- Violation of statute of frauds (see *Question 3*).

Contract Remedies

21. What are the main remedies available for breach of contract?

Damages

Courts overwhelmingly prefer damages as a remedy and usually only resort to equitable (non-monetary) remedies if the legal remedy (damages) is inadequate.

In all cases, the plaintiff must prove that the losses suffered were certain in their nature and not speculative. Traditionally, lost profits were often found too speculative to be awarded. However, the courts may now allow lost profit damages if these can be made more certain by reference to similar businesses in the area or other businesses previously operated by the same party, or where an engagement to pay them can be found in the terms of the contract.

Punitive or exemplary damages (that is, awarded to punish a defendant for wrongful conduct) are generally not awarded in contract cases.

Expectation damages. The standard measure of damages in contract cases is expectation damages. Expectation damages provide sufficient damages for the non-breaching party to be in as good a position as it would have been in had the contract been performed.

Reliance damages. If the plaintiff's expectation damages are too speculative to measure, the plaintiff can elect to recover damages on a reliance basis. Reliance damages award the non-breaching party the cost of their performance (that is, they put the plaintiff in the position they would have been in had the contract never been formed).

Consequential damages. Consequential damages are special damages reflecting losses over and above expectation damages, usually lost profits resulting from the breach. These damages can only be recovered if, at the time the contract was made, a reasonable person would have foreseen the damages as a probable result of the breach. The burden is on the plaintiff to show that the breaching party had reason to know of those special circumstances.

Incidental damages. Incidental damages may be available for breaches of sale of goods contracts. These damages are expenses incurred after the breach to mitigate the resulting losses. Incidental damages can only be recovered if they are a reasonably contemplated result of the breach or arise from the breach itself. Incidental damages include expenses reasonably incurred by:

- The buyer for the inspection, receipt, transportation, care, and custody of goods rightfully rejected and other expenses reasonably incident to the seller's breach.
- The seller in storing, shipping, returning, and reselling the goods as a result of the buyer's breach.

Nominal damages. Nominal damages can be awarded where a breach is shown but no actual loss is proven.

Liquidated damages. See *Question 22*.

For a discussion on the categories of damages available for breach of contract, see *Practice Note, Damages for Breach of Commercial Contracts*.

Specific Performance

Specific performance is a court order that requires a party to perform its obligations under a contract. Specific performance can be awarded if the subject matter of the contract is unique or rare. Real property is almost always considered unique. Specific performance is never awarded for service contracts, as this is considered as tantamount to involuntary servitude, which is prohibited by the US Constitution.

In contrast, a court can enjoin a breaching employee to not work for a competitor throughout the duration of a contract if the services contracted for are rare or unique. Further, most courts enforce non-compete covenants if both:

- The services to be performed are unique (rendering damages inadequate).
- The covenant is reasonable, that is:
    - necessary to protect a legitimate interest of the beneficiary of the covenant;
    - reasonable in its geographic scope and duration (that is, it cannot be broader than the benefited person's customer base and typically cannot last longer than one or two years); and
    - the covenant does not harm the public.

For further information, see *Practice Note, Contracts: Equitable Remedies: Specific Performance*.

Reformation

Reformation is a court order effectively rewriting the agreement between the parties to conform to the original intent of the parties. Reformation is rarely available but may be considered if there is either mistake or misrepresentation.

To reform a contract because of mistake, there must be all of the following:

- An agreement between the parties.
- An agreement to put that agreement in writing.
- A variance between the original agreement and the resulting written agreement.

If the final writing is inaccurate due to a misrepresentation, the plaintiff may have the choice between avoidance and reformation. If reformation is available, the court will reform the contract to the expressed intent of the parties.

In all cases of reformation, the variance between the intended agreement and the writing must be established by clear and convincing evidence.

Once the contract is reformed, the court enforces the contract as rewritten.

For further information, see *Practice Note, Contracts: Equitable Remedies: Reformation*.

22. Are clauses setting out a fixed or ascertainable amount of compensation/damages valid in your jurisdiction? Are these clauses subject to any limitation?

Liquidated damages are damages the amount of which is fixed by the contract for specified breaches (for example, damages of USD1,000 per day in cases of delayed performance). Liquidated damages must be in an amount that is reasonable in view of the actual or anticipated harm caused by the breach. Liquidated damages are enforceable if both:

- Damages for contractual breach are difficult to estimate or ascertain at the time the contract was formed.
- The amount agreed on is a reasonable forecast of compensatory damages in the case of breach. If the amount is found to be unreasonable, the courts will construe the clause as a penalty and will not enforce the provision.

The UCC allows a court to consider actual damages to validate a liquidated damages clause. Therefore, under the UCC, even if a liquidated damages clause was not a reasonable forecast at the time of formation, it will be valid if it was reasonable in light of subsequent actual damages. If the court finds that the liquidated damages requirements are met, the plaintiff can receive the liquidated damages even if no actual money or pecuniary damages have been suffered.

Penalty clauses are generally unenforceable due to public policy concerns (see Restatement (First) of Contracts § 339(1), cmt. A). For example, section 356 of the Restatement (Second) of Contracts provides that:

- A term fixing an unreasonably large liquidated damages sum is unenforceable on public policy grounds.
- A term in a bond providing for an amount of money as a penalty for non-occurrence is unenforceable on public policy grounds to the extent that the amount exceeds the loss caused by the non-occurrence.

A payment promised may constitute a penalty even though it is expressly described in the contract as liquidated damages, and vice versa.

The test for a penalty combines two factors:

- **Anticipated or actual loss caused by the breach.** The amount fixed is reasonable where it approximates actual loss that has resulted from the breach, and to the extent it approximates the loss anticipated at the time of the making of the contract.
- **Difficulty of proof of loss.** The greater the difficulty of proving loss or of establishing its amount with the requisite certainty, the easier it is to show that the amount fixed is reasonable. Where there is uncertainty as to harm, the court's or jury's estimate may not accord with the principle of compensation any more than does the advance estimate of the parties.

(Restatement (Second) of Contracts § 356, cmt. b.)

An agreement simply limiting the amount of damages recoverable for breach does not constitute liquidated damages or a penalty.

Choice of Foreign Law and Jurisdiction

Choice of Law

23. Is the choice of a foreign law in a contract upheld by local courts?

Foreign forum selection clauses and choice of law clauses are presumptively enforceable. The parties' contractual choice of forum or choice of law is enforced except in the most unusual cases. The party resisting the clause has the burden of establishing that the public interest in setting aside the clause outweighs the parties' choice. This presumption applies regardless of whether the forum or law specified in the clause is a US federal or state court or law or a foreign court or law. For a discussion of choice of law and choice of forum issues parties should consider when drafting contracts, see *Practice Note, Choice of Law and Choice of Forum: Key Issues*.

Jurisdiction

24. Is the choice of a foreign jurisdiction in a contract upheld by local courts?

See *Question 23*.

Other Key Issues

25. Are there additional and important issues of law and practice relating to contract formation and enforcement that are not otherwise addressed in this Q&A?

Not applicable.

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