



Business/Marketing Virtual Learning

10-12 grade Business Law

May 7, 2020



Lesson: [May 7, 2020]

Objective/Learning Target:
Consideration

Describe situations in which consideration is present only under limited circumstances.

Let's Get Started

Watch this Video:

[Illusory Promise](#)



Circumstantial Consideration

Certain forms of consideration are only legally binding in the proper circumstances. If these circumstances, in the form of properly worded contract provisions or patterns of behavior are not present, what would appear to be valid consideration is not.

1) **Illusory Promises**

To be consideration, a promise must be binding. In other words, the promise must create a duty or impose an obligation. If a contract contains a clause that allows you to escape the legal obligation, your promise creating the obligation is said to be *illusory*. For example, you might have a clause stating that you will “paint the house—if you have time.” This does not increase your legal obligation because you may never have time to paint the house.

a) **Termination Clauses** - Businesses often want the power to withdraw from a contract if business circumstances change. Therefore they include termination clauses in their contracts. If the clause gives one party the power to terminate the contract for any reason, the promise to perform would be illusory.

The promise is not illusory if termination is allowed only after a change in defined circumstances, after the passage of a certain length of time, or after a set period after a notice of termination is given.

Circumstantial Consideration

- b) **Output and Requirements Contracts** - Buyers sometimes agree to purchase all of a particular producer's production. For instance, a steel company may buy all of the output of a nearby coal mining company. This is an **output contract**. On the other hand, a seller may agree to supply all of the needs of a particular buyer. For instance, a carburetor manufacturer may agree to supply all the carburetors needed for the production of a certain make of vehicle. This is a **requirements contract**.
- It may seem that one party could elect to stop production and thereby eliminate the obligation. However, courts recognize these contracts as supported by consideration because they impose a duty of fair dealing on the parties. In doing so the courts recognize that no business should be required to go bankrupt by staying in an output or requirements contract that has become unprofitable through no fault of the terminating party.

Circumstantial Consideration

2) Existing Duty

A person sometimes promises to do something that he or she already is obligated to do by law or by prior contract. Such a promise, or act, cannot serve as consideration to bind the other party to a later contract.

- a) **Existing Public Duty** - Public servants, in taking their oath of office or by the very nature of their position, make explicit and/or implied promises to perform various duties. While serving their term in these public capacities, they cannot use promises to perform or actual performance of the same duties as consideration for the promises of another. For example, if a police officer apprehends an escaped convict for whom a large reward has been offered, the officer cannot collect it. She or he is already under a duty as an officer of the law to capture such wanted parties. Therefore, the performance of apprehending the escapee cannot be used as consideration to bind the offeror to the promise of paying a reward.
- b) **Existing Private Duty** - If a contract creates a duty, this duty cannot be the basis of consideration in a different contract. The same rule holds true when a person demands further compensation for carrying out a contractual promise already made.

Circumstantial Consideration

- c) **Settlement of Liquidated Debts** - A **liquidated debt** is one where the parties agree that the debt exists and on the amount of the debt. When a creditor (a person to whom a debt is owed) agrees to accept less than the total amount due in full settlement from a debtor (a person who owes money to a creditor) there is no consideration if the debt is liquidated.
- Assume that Shawver borrows \$1,000 from Reno. The loan is to be paid in one year with interest at 10 percent per year, or a total amount of \$1,100. On the due date, Shawver sends Reno a check for only \$1,000, saying "Sorry, I'm strapped for cash. You will have to accept this in full payment." Reno endorses (signs) and cashes the check. Reno may later sue and recover the unpaid balance of \$100. She has received no consideration for the suggested agreement to reduce the amount due.
- A debtor can settle a claim by paying less than the full amount if additional consideration is given. For example payment of less than the full amount before the due date could be consideration. However, there must be mutual agreement between the creditor and debtor to do so. Valid consideration exists because the creditor receives the benefit of early payment. If something extra is given by the debtor, the new consideration supports a voluntary release by the creditor.

Circumstantial Consideration

- d) **Settlement of Unliquidated Debts** - When there is a genuine dispute between the parties about how much is owed, the debt is referred to as unliquidated. In such cases, a payment offered in full settlement by the debtor and accepted by a creditor settles the claim. This process is called an **accord and satisfaction**. For example, a debtor may in good faith claim that a certain debt is \$500. The creditor in good faith contends that it is \$1,000. If the parties compromise on \$750, their new agreement on that sum is referred to as the accord. Consideration for the accord is found in their mutual forbearance from litigating over the amount owed. When the subsequent agreement is performed, in this case the amount of \$750 is paid, the act is referred to as the satisfaction.
- e) **Release** - In most instances when a tort occurs, the liability is unliquidated because the extent of damages is uncertain. Often due to financial pressure, an injured party in the tort will agree to discharge another from liability for the tort in return for a monetary payment or other consideration. This discharge agreement is termed a **release**.
- f) **Composition with Creditors** - Occasionally a group of creditors will cooperatively agree to accept less than what they are entitled to, in full satisfaction of their claims against a debtor. In return, the debtor agrees not to file for bankruptcy. This is called a **composition with creditors**. Consideration for the promise of each creditor to release the debtor from full payment is found in the reciprocal promises of the other creditors to refrain from suing for the entire amounts due them. If the creditors did not agree to this arrangement, the debtor could file for bankruptcy, and the creditors might receive much less as a consequence.

ACTIVITY #24

- 1) Why is consideration not binding in illusory contracts?
- 2) If a lumber company agrees to supply all of the lumber needs of a builder, what kind of contract would the two parties enter into?
- 3) Using an extremely strong and lightweight composite material, Databuster Inc. created the Slice, a notebook computer weighing less than one pound with a 17” screen. The Slice immediately grabbed a majority share of the notebook computer market. To ensure a steady supply of microprocessors for the production of the Slice, Databuster contracted to buy computer chips from the Chipshop. The Chipshop in turn geared up two new production lines to meet Databuster’s demand. Barely eight months later, Databuster learned of a new company offering a chip that produced twice the speed—and cost half the price—of the Chipshop’s chip. Databuster started buying all the chips it needed to manufacture the Slice from this new company. The Chipshop brought suit for breach of contract.
 - a) Will the Chipshop win the lawsuit?
 - b) Why or why not?