Solution and Answer Guide

Miller, Business Law Today, Comprehensive Edition: Text & Cases 13e, 9780357634783;
Chapter 10: Nature and Classification

Table of Contents

[Critical Thinking Questions in Cases 1](#_Toc63162982)

[Case 10.1 1](#_Toc63162983)

[Case 10.2 2](#_Toc63162984)

[Case 10.3 3](#_Toc63162985)

[Chapter Review 3](#_Toc63162986)

[Practice and Review 3](#_Toc63162987)

[Practice and Review: Debate This 4](#_Toc63162988)

[Issue Spotters 5](#_Toc63162989)

[Business Scenarios and Case Problems 5](#_Toc63162990)

[Critical Thinking and Writing Assignments 12](#_Toc63162991)

# Critical Thinking Questions in Cases

Case 10.1

1. As a principle of contract interpretation, courts consistently strive to interpret contracts in accord with common sense. Does the application of this principle to the facts in this case support or undercut the decision of the Maryland Court of Appeals? Explain.

Solution

Applying the principle that a contract should accord with common sense supports the decision of the Maryland Court of Appeals in the *Credible* case. Interpreting the promissory note to require repayment only if an employee quits, as the lower courts did, defies common sense.

The lower courts’ interpretation of the repayment term of the note, making its repayment dependent on whether an employee was fired or quit, would result in disparate treatment. In those courts’ view, an employee fired by Credible would not be required to repay the loan, while an employee who quits would be required to repay. There is no reason why, with respect to repayment of the loan, an employee who is fired should be treated more favorably than one who quits. In the words of the Maryland Court of Appeals, this interpretation “strains credulity, \* \* \* is untenable and runs contrary to common sense.”

In addition to according with common sense, the interpretation of the state’s highest court of the two provisions referred to in the “Reason” section of the case brief aligns the meaning and substance of those provisions, showing clearly that the parties intended the loan to be repaid regardless of whether an employee quits or is fired.

1. What consequences might Credible have suffered if the Maryland Court of Appeals had interpreted the terms of the note to require repayment only when an employee quit employment, not when that employee was fired? Discuss.

Solution

In the *Credible* case, Credible argues that the terms of the promissory note memorializing an agreement between the employer and its employee, as part of the employer’s tuition loan program, requires repayment regardless of whether the employee quits or is fired. According to the note, this is the intent of the parties—Credible and the employee—who agree to those terms. The Maryland Court of Appeals holds that this contention is a reasonable interpretation, in contrast to the argument of Credible’s employee-borrower, Emmanuel Johnson, who posits that the terms of the note requires repayment only if an employee quits the job.

If the court had agreed with Johnson, however, the consequences to Credible might have begun with the way in which its other employees subsequently regarded their employment and its termination. An involuntary discharge could mean that a fired employee would reap a windfall in terms of the repayment of a tuition loan. This circumstance would seem to encourage employees to obtain the loans and, when they wished to change their employment or desired simply to avoid repayment of what, given the cost of tuition, could be a substantial amount (plus interest), act in a manner so as to be fired. The result would not only be the cost to Credible of the loss of the amount of the loan, but havoc in the workplace, due to the employee’s effort to get fired. This sort of misconduct would create disharmony in the workplace, lowering productivity, and undermining the economic and social objectives of the business.

Case 10.2

1. Could Panera have successfully argued that a drop in its revenue allowed it to impose the cap? Why or why not?

Solution

No, a drop in Panera’s revenue would not have supported the employer’s decision to change the terms of its unilateral contract to pay bonuses to its managers.

Panera might have argued that such an economic downturn allowed it to impose a cap on the amount of the bonuses because the purpose of the contract with the managers had been commercially frustrated. But an economic downturn is a foreseeable event that an employer should anticipate when making a bonus offer. For example, Panera could have accounted for this possibility when it devised the bonus program and used different criteria to determine the amounts. Under the circumstances, Panera bore the risk of changes in revenue.

Similarly, the decline in general business conditions that on which Panera based its action in the *Boswell* case was foreseeable. Business is risky. Markets can be undependable.

1. Does the fact that the managers continued to work for Panera after it imposed the cap undercut their claim? Explain.

Solution

No. Panera’s imposition of the cap on the amount of the bonuses was a repudiation of its original offer. That is, the modification of the terms of the promise after the managers had begun to perform was a breach of the deal. But, in such a circumstance, the managers were free to continue performing. They did not have to regard the repudiation as an immediate breach. They could continue to perform until they were convinced that their employer was not going to restore the original term, at which time they could, as they did, file a suit for breach.

By simply continuing to work, the managers could be held to have accepted the modification of their contract with their employer. In this case, silence is not acceptance. Something more than simply continuing to work would be needed to show the managers’ acceptance of their employer’s unilateral modification.

Case 10.3

1. How might the result in this case have been different if the court had allowed Wagner’s extrinsic evidence of a prior contract regarding *Love Song* to be used as evidence in this dispute?

Solution

In this circumstance, the court might have construed the language of the “Charlie’s Angels” contract to the same effect. But because Columbia acquired the movie rights to the property independ­ent of any right it might have had in relation to the television series, the court might still have considered the acquisition separate from the exploitation rights covered by the Wagner contract, and the result would have been the same.

# Chapter Review

Practice and Review

Mitsui Bank hired Ross Duncan as a branch manager in one of its Southern California locations. At that time, Duncan received an employee handbook informing him that Mitsui would review his performance and salary level annually. In 2020, Mitsui decided to create a new lending program to help financially troubled businesses stay afloat. It promoted Duncan to be the credit development officer (CDO) and gave him a written compensation plan. Duncan’s compensation was to be based on the new program’s success and involved a bonus and commissions based on new loans and sales volume. The written plan also stated, “This compensation plan will be reviewed and potentially amended after one year and will be subject to such review and amendment annually thereafter.”

Duncan’s efforts as CDO were successful, and the business-lending program he developed grew to represent 25 percent of Mitsui’s business in 2021 and 40 percent by 2023. Nevertheless, Mitsui refused to give Duncan a raise in 2021. Mitsui also amended Duncan’s compensation plan to significantly reduce his compensation and to change his performance evaluation schedule to every six months. When he had still not received a raise by 2023, Duncan resigned as CDO and filed a lawsuit claiming breach of contract. Using the information presented in the chapter, answer the following questions.

1. What are the four requirements of a valid contract?

Solution

The four requirements for any contract to be valid are agreement, consideration, capacity, and legality.

1. Did Duncan have a valid contract with Mitsui for employment as credit development officer? If so, was it a bilateral or a unilateral contract?

Solution

Yes, Duncan had a valid contract with Mitsui for employment as credit develop­ment officer. The contract was bilateral because it was a promise for a promise—to work in exchange for compensation. No performance was necessary. The con­tract existed as soon as the promises were exchanged. The contract was valid be­cause the parties had an agreement, consideration (employment in exchange for payment), capacity (presumed, especially with businesses and businesspersons), and the agreement was legal.

1. What are the requirements of an implied contract?

Solution

Implied contracts are contracts formed by the parties’ conduct rather than by their words. For an implied contract to exist, the plaintiff must furnish some property or service to the defendant expecting to be paid, the defendant must know or should know that the plaintiff expects to be paid, and the defendant must have a chance to reject the property or service and does not.

1. Can Duncan establish an implied contract based on the employment manual or the written compensation plan? Why or why not?

Solution

To establish an implied contract in these circumstances, the plaintiff must have furnished a service to the defendant expecting to be paid, the defendant must have known that the plaintiff expected to be paid, and the defendant must have had a chance to reject the service. Here, Duncan provided service as a credit development officer to Mitsui, who hired and agreed to pay him for this service and accepted the service as it was rendered. Presumably, the initial hiring and duties of the position were discussed between the parties, if not put in writing, and were thus express, not implied. But the terms set out in the employment manual and written compensation plan were clearly express, not implied, as indi­cated by the quote from the plan.

Practice and Review: Debate This

1. Companies should be able to make or break employment contracts whenever and however they wish.

Solution

Companies, especially large corporations, hold all of the cards with respect to their actual and future employees. Absent statutes and case law that limits their abilities to break employment contracts on a whim, employees would have no protections. Employees would face increased uncertainty about the longevity of their jobs, which ultimately would reduce their productivity. There would be more turnover in jobs, and more unemploy­ment. Contracts are not made to be broken, but rather upheld—and that is where the courts come in. The courts must be there to protect the rights of aggrieved former employees.

Employers, even large corporations, do not “hold all of the cards,” contrary to popular belief. All companies compete for workers. It would be foolish for com­panies to break employment contracts on a whim. After all, it’s costly to train new workers. The reality is that good workers are highly valued and companies must pay competitive wages (or more) to keep workers. So, even if companies had no legal constraints about how they honor their contracts with employees, they have a business reason to honor those contracts—lower labor costs, greater em­ployee productivity, and ultimately, higher profits.

Issue Spotters

1. Kerin sends a letter to Joli telling her that he has a book to sell at a certain price. Joli signs and returns the letter. When Kerin delivers the book, Joli sends it back, claiming that they do not have a contract. Kerin claims they do. What standard determines whether these parties have a contract?

Solution

Under the objective theory of contracts, if a reasonable person would have thought that Joli had accepted Kerin’s offer when she signed and returned the letter, then a contract was made, and Joli is obligated to buy the book. This depends, in part, on what was said in the letter and what was said in response. For instance, did the letter contain a valid offer, and did the response constitute a valid acceptance? Under any circumstances, the issue is not whether either party subjectively believed that a contract had been made.

1. Dyna tells Ed that she will pay him $1,000 to set fire to her store, so that she can collect under a fire insurance policy. Ed sets fire to the store but Dyna refuses to pay. Can Ed recover? Why or why not?

Solution

No. This contract, although not fully executed, is for an ille­gal purpose and therefore is void. A void contract gives rise to no legal obligation on the part of any party. A contract that is void is no contract. There is nothing to enforce.

Business Scenarios and Case Problems

1. **Unilateral Contract.** Rocky Mountain Races, Inc., sponsors the “Pioneer Trail Ultramarathon,” with an advertised first prize of $10,000. The rules require the competitors to run one hundred miles from the floor of Blackwater Canyon to the top of Pinnacle Mountain. The rules also provide that Rocky reserves the right to change the terms of the race at any time. Monica enters the race and is declared the winner. Rocky offers her a prize of $1,000 instead of $10,000. Did Rocky and Monica have a contract? Explain. (See *Types of Contracts*.)

Solution

Yes, these parties had a contract. Contests, lotteries, and other competitions for prizes are offers for contracts. Here, the offer is phrased so that each competitor can accept only by completing the run. At that point, a contract is formed—a uni­lateral contract—binding its sponsor to perform as promised. Rocky did not breach the contract when the prize was changed. Under the rules, Rocky could change the terms at any time.

1. **Implied Contract.** Janine was hospitalized with severe abdominal pain and placed in an intensive care unit. Her doctor told hospital personnel to order around-the-clock nursing care for Janine. At the hospital’s request, a nursing services firm, Nursing Services Unlimited, provided two weeks of in-hospital care and, after Janine was sent home, two additional weeks of at-home care. During the at-home period of care, Janine was fully aware that she was receiving the benefit of the nursing services. Nursing Services later billed Janine $4,000 for the nursing care, but Janine refused to pay on the ground that she had never contracted for the services, either orally or in writing. In view of the fact that no express contract was ever formed, can Nursing Services recover the $4,000 from Janine? If so, under what legal theory? Discuss. (See *Types of Contracts*.)

Solution

Janine was unconscious or otherwise unable to agree to a contract for the nursing services she received while she was in the hospital. Under the doctrine of quasi contract, however, the law will sometimes create a fictional contract in order to prevent one party from unjustly receiving a benefit at the expense of another. Quasi contract provides a basis for Nursing Services to recover the value of the services it provided while Janine was in the hospital.

Nursing Services can recover for the at-home services under an implied contract because Janine was aware that the services were being provided for her. Under this type of contract, the conduct of the parties creates and defines the terms. Janine’s acceptance of the services constitutes her agreement to form a contract, and she will probably be required to pay Nursing Services in full.

1. **Contract Classification.** For employment with the Firestorm Smokejumpers—a crew of elite paratroopers who parachute into dangerous situations to fight fires—applicants must complete a series of tests. The crew chief sends the most qualified applicants a letter stating that they will be admitted to Firestorm’s training sessions if they pass a medical exam. Jake Kurzyniec receives the letter and passes the exam, but a new crew chief changes the selection process and rejects him. Is there a contract between Kurzyniec and Firestorm? If there is a contract, what type of contract is it? (See *Types of Contracts*.)

Solution

Yes, Firestorm and Scott had a contract. The letter was a unilateral offer phrased so that the offeree could accept only by completing the required performance. The contract was formed when the performance was complete. This was a unilateral contract. Here, Scott accepted the offer by passing the medical exam. Firestorm breached the contract when the new crew chief rejected Scott, who had already received the offer and accepted it. The appropriate remedy would be to allow Scott to attend Firestorm’s training sessions.

1. **Spotlight on Taco Bell—Implied Contract.** Thomas Rinks and Joseph Shields developed Psycho Chihuahua, a caricature of a Chihuahua dog with a “do-notback-down” attitude. They promoted and marketed the character through their company, Wrench, LLC. Ed Alfaro and Rudy Pollak, representatives of Taco Bell Corp., learned of Psycho Chihuahua and met with Rinks and Shields to talk about using the character as a Taco Bell “icon.” Wrench sent artwork, merchandise, and marketing ideas to Alfaro, who promoted the character within Taco Bell. Alfaro asked Wrench to propose terms for Taco Bell’s use of Psycho Chihuahua. Taco Bell did not accept Wrench’s terms, but Alfaro continued to promote the character within the company.

Meanwhile, Taco Bell hired a new advertising agency, which proposed an advertising campaign involving a Chihuahua. When Alfaro learned of this proposal, he sent the Psycho Chihuahua materials to the agency. Taco Bell made a Chihuahua the focus of its marketing but paid nothing to Wrench. Wrench filed a suit against Taco Bell in a federal court claiming that it had an implied contract with Taco Bell and that Taco Bell breached that contract. Do these facts satisfy the requirements for an implied contract? Why or why not? [*Wrench, LLC. v. Taco Bell Corp*., 256 F.3d 446 (6th Cir. 2001), *cert. denied*, 534 U.S. 1114, 122 S.Ct. 921, 151 L.Ed.2d 805 (2002)] (See *Types of Contracts*.)

Solution

The court held that Wrench submitted sufficient evidence of an implied con­tract to survive Taco Bell’s motion for summary judgment on the issue. “Implied in fact contracts often arise where one accepts a benefit from another for which compen­sation is customarily expected. Thus, where evidence shows that the parties un­derstood that compensation would be paid for services rendered, a promise to pay fair value may be implied, even if no agreement was reached as to price, duration, or other terms of the contract.” Here, “Taco Bell concedes that there is suffi­cient evidence in the record to support Plaintiff’s allegation that the parties had a basic understanding that if Taco Bell used the Psycho Chihuahua idea, concept, or im­age, that Taco Bell would compensate Plaintiffs for the fair value of such use.” Furthermore, “[t] he cases establish that a plaintiff may support a claim of im­plied in fact contract by showing that the plaintiff disclosed an idea to the defend­ant at the defendant’s request and the defendant understood that the plaintiff ex­pected compensation for use of his ideas.

Because Taco Bell concedes that there is sufficient evidence to support such an understanding in this case, Taco Bell’s as­sertion that Plaintiffs cannot establish an implied in fact contract must be re­jected.” The court ruled against Wrench on other grounds. Wrench appealed to the U.S. Court of Appeals for the Fifth Circuit, which agreed with the lower court’s holding on Wrench’s implied contract claim (but reversed the ruling on the other grounds).

1. **Business Case Problem with Sample Answer—Implied Contracts.** Ralph Ramsey insured his car with Allstate Insurance Co. He also owned a house on which he maintained a homeowner’s insurance policy with Allstate. Bank of America had a mortgage on the house and paid the insurance premiums on the homeowner’s policy from Ralph’s account. After Ralph died, Allstate canceled the car insurance. Ralph’s son Douglas inherited the house. The bank continued to pay the premiums on the homeowner’s policy, but from Douglas’s account, and Allstate continued to renew the insurance. When a fire destroyed the house, Allstate denied coverage, however, claiming that the policy was still in Ralph’s name. Douglas filed a suit in a federal district court against the insurer. Was Allstate liable under the homeowner’s policy? Explain. [*Ramsey v. Allstate Insurance Co*., 514 Fed.Appx. 554 (6th Cir. 2013)] (See *Types of Contracts*.)

Solution

Yes, Allstate was liable under the homeowner’s policy. A contract that is implied from the conduct of the parties. This type of contract differs from an express contract in that the conduct of the parties, rather than their words, creates and defines the terms of the contract. For an implied contract to exist, a party must furnish a service or property (which includes money), the party must expect to receive something in return for that property or service, and the other party must know or should know of that expectation and had a chance to reject the property or service but did not. Of course, a contract may be a mix of express and implied terms.

In this problem, the homeowner’s policy was a mix of express and implied terms. As for the elements showing the existence of the implied terms, the payments for the premiums on the policy continued after Ralph’s death, but the amounts were paid from Douglas’s account. Undoubtedly, Douglas expected to receive coverage under the policy in return for his payments. The insurer Allstate must have known that Douglas expected the coverage—insurance has long been Allstate’s business, and the company obviously understands the relationship between the payments of premiums and the expectation of insurance coverage. And Allstate had the opportunity to cancel the homeowner’s policy—as it had with Ralph’s auto insurance, which was canceled—but did not terminate it.

In the actual case on which this problem is based, the court issued a judgment in Allstate’s favor on the implied contract issue. The U.S. Court of Appeals for the Sixth Circuit reversed this judgment—“A reasonable fact-finder could determine that [Allstate’s] continuation of the premium payments constituted a contract implied in fact with Douglas.”

1. **Quasi Contracts.** Lawrence M. Clarke, Inc., was the general contractor for construction of a portion of a sanitary sewer system in Billings, Michigan. Clarke accepted Kim Draeger’s proposal to do the work for a certain price. Draeger arranged with two subcontractors to work on the project. The work provided by Draeger and the subcontractors proved unsatisfactory. All of the work fell under Draeger’s contract with Clarke. Clarke filed a suit in a Michigan state court against Draeger, seeking to recover damages on a theory of quasi contract. The court awarded Clarke $900,000 in damages on that theory. A state intermediate appellate court reversed this award. Why? [*Lawrence M. Clarke, Inc. v. Draeger*, 2015 WL 205182 (Mich.App. 2015)] (See *Quasi Contracts*.)

Solution

The appellate court reversed the lower court’s award to Clarke of $900,000 in damages on a quasi contract theory because the dispute fell under Draeger’s contract with Clarke. The doctrine of quasi contract generally does not apply when an existing contract covers the area in controversy. In that circumstance, the nonbreaching party can sue the breaching party for breach of the contract.

Here, Lawrence M. Clarke, Inc., was the general contractor for the construction of a portion of a sanitary sewer system. Kim Draeger proposed to do the work for a certain price, and Clarke accepted. Draeger arranged with two subcontractors to work on the project. But Draeger and the subcontractors provided less than perfect, competent, or complete work. Clarke filed a suit in against Draeger to recover damages on a theory of quasi contract. The court awarded Clarke damages on that theory. An appellate court reversed this award because all of the work and its disputed performance were covered by Draeger’s contract with Clarke.

In the actual case on which this problem is based, in Clarke’s action against Draeger, the court chose to decide the case under the theory of quasi contract. A state intermediate appellate reversed the decision on the ground stated above.

1. **Interpretation of Contracts.** Lehman Brothers, Inc. (LBI), wrote a letter to Mary Ortegón offering her employment as LBI’s “Business Chief Administrative Officer in Its Fixed Income Division.” The offer included a salary of $150,000 per year and an annual “minimum bonus” of $350,000. The letter stated that the bonus would be paid unless Ortegón resigned or was terminated for certain causes. In other words, the bonus was not a “signing” bonus—it was clearly tied to her performance on the job. Ortegón accepted the offer. Before she started work, however, LBI rescinded it. Later, LBI filed for bankruptcy in a federal court. Ortegón filed a claim with the court for the amount of the bonus on the ground that LBI had breached its contract with her by not paying it. Can extrinsic evidence be admitted to interpret the meaning of the bonus term? Explain. [*Ortegón v. Giddens*, 638 Fed.Appx. 47 (2d Cir. 2016)] (See *Interpretation of Contracts*.)

Solution

No, extrinsic evidence is not admissible to interpret the meaning of the bonus term in this problem. When a dispute arises over the meaning of a term in a contract, a court will enforce it according to its obvious terms if the contract’s writing is clear. Under the plain meaning rule, the meaning of the term is determined from the written document alone. If a term is ambiguous, a court can consider extrinsic evidence.

In this problem, Lehman Brothers, Inc., (LBI) offered Mary Ortegón a job. The offer included an annual “minimum bonus” of $350,000. The bonus was to be paid unless Ortegón quit or was terminated for certain causes. The bonus was clearly tied to Ortegón’s performance on the job .It was not a “signing” bonus. Ortegón accepted the offer, but before she started work, LBI rescinded it. Later, LBI filed for bankruptcy. Ortegón filed a claim for the amount of the bonus on the ground that LBI breached its contract with her by not paying it. Because the expressed term concerning the bonus is clear, under the plain meaning rule extrinsic evidence is not admissible to interpret it. The contract clearly provided that the bonus was part of Ortegón’s compensation for her performance on the job. Ortegón never became LBI’s employee and never started to perform. Thus Ortegón never had any right to the bonus, and LBI did not breach their contract when it refused to give it to her.”

In the actual case on which this problem is based, James Giddens, the bankruptcy trustee, denied the claim, and the court issued a judgment in the trustee’s favor. The U.S. Court of Appeals for the Second Circuit affirmed this judgment on the reasoning stated above.

1. **Quasi Contracts.** In New Jersey, a patient admitted to a medical care facility through the regular admissions process is responsible for applying to the state for assistance in paying the bill. In contrast, a patient admitted on an emergency basis is not responsible for applying to the state—the facility is. Of course, to obtain assistance, the patient must be indigent. D.B., a diagnosed schizophrenic, experienced a psychotic episode. The Warren County, New Jersey, psychiatric emergency screening service determined that he was a danger to himself and others. He was involuntarily committed to Newton Medical Center, a mental health-care facility. Newton did not apply to the state for financial assistance for D.B.’s treatment. Instead, Newton billed the patient $6,745.50. D.B., who was indigent, did not pay. Can Newton recover the amount of the unpaid bill from D.B. on a theory of quasi contract? Discuss. [Newton Medical Center v. D.B., 452 N.J.Super. 615, 178 A.3d 1281, 2018 WL 480296 (App.Div. 2018)] (See *Quasi Contracts*.)

Solution

No, Newton cannot recover the amount of the unpaid bill from D.B. Quasi contracts are equitable in nature, imposed to avoid the unjust enrichment of one party at the expense of another. A quasi contract is not based on an actual agreement, but on the theory that an individual should not profit inequitably at another’s expense. Of course, a party who confers a benefit through negligence or other misconduct cannot invoke the theory.

As stated in the facts of the problem, in New Jersey, state assistance in paying medical bills is available for patients who are indigent. A patient admitted to a care facility via a regular admission process is responsible for applying to the state for that help. In contrast, when a patient is admitted on an emergency basis, this responsibility belongs to the facility, not the patient.

In the problem, D.B., an indigent schizophrenic, was involuntarily committed to Newton Medical Center on the determination of a psychiatric emergency screening service that he was a danger to himself or others. After treatment, Newton billed the patient $6,745.50. D.B. did not pay the bill, but the facility did not apply to the state for financial assistance to cover the cost. Due to this carelessness or oversight, the facility is not entitled to recover the unpaid bill on a theory of quasi contract.

In the actual case on which this problem is based, the court issued a judgment in Newton’s favor, but a state intermediate appellate court reversed, on the reasoning stated above.

1. **A Question of Ethics—The IDDR Approach and Contract Requirements.** Mark Carpenter, a certified financial planner, contracted to recruit investors for GetMoni.com, which owned a defunct gold mine in Arizona. Carpenter then contracted with clients to invest their funds, sending more than $2 million to GetMoni.com. Only about 20 percent of the money went to developing the mine. The rest was used to run a Ponzi scheme. Carpenter collected another $1 million, but instead of sending it to GetMoni.com, he deposited it into his own account. A federal investigation unraveled the scheme. Carpenter was charged with two counts of fraud—one for his deal with GetMoni.com and one for his misrepresentations to clients after he stopped dealing with GetMoni.com. [*United States v. Carpenter*, 676 Fed.Appx. 397 (6th Cir. 2017)] (See *An Overview of Contract Law*.)
2. Which elements do Carpenter’s contracts lack, preventing them from being enforced? Can he argue successfully that he acted ethically? Discuss.

Solution

The elements that these contracts lack are legality and voluntary consent. Legality is one of the four requirements that must be met for a contract to be valid. A contract’s purpose must be to accomplish a goal that is legal. Among the defenses to a contract that might otherwise be enforceable is voluntary consent—the consent of both parties must be voluntary. If a contract is formed as a result of fraud, the contract may not be enforceable.

In this problem, Mark Carpenter contracted to recruit investors for GetMoni.com, which owned a defunct gold mine in Arizona. Carpenter further contracted with clients to invest their funds in the mine, collecting more than $2 million that he sent to GetMoni.com. He collected another $1 million from the investors, but deposited the money into his own accounts rather than sending it to GetMoni.com. None of the contracts was for a legal purpose. Instead, their purpose was to defraud investors and spend the ill-gotten proceeds other than as represented. And there was no voluntary consent. Carpenter entered into all of the contracts with fraudulent intent, keeping investors’ funds for himself.

When investigators uncovered the scheme, Carpenter was charged with two counts of fraud—one for his deal with GetMoni.com and one for his misrepresentations to clients after he stopped dealing with GetMoni.com. With regard to the latter situation, he might argue that he continued to accept client funds without passing them on to GetMoni.com in order to repay some of the investors, not to defraud them. This is the closest contention that he might have to an argument he acted ethically. But it would fail. Even if it were true, he acted with fraudulent intent. Under most standards of ethics, one’s ultimate motivation is irrelevant.

In the actual case on which this problem is based, the court convicted Carpenter of the charges. The U.S. Court of Appeals for the Sixth Circuit affirmed the convictions

1. Using the IDDR approach, discuss whether certified financial planners have an ethical obligation to contract in the best interests of their clients.

Solution

A certified financial planner (CFP) should have an ethical obligation to contract in the best interests of any clients. As with other ethical duties, this may not be enforceable at law. But it should be part of a CFP’s job description.

The IDDR approach starts with an Inquiry to identify the issue, the stakeholders, and the ethical standards. The issue is phrased in the question: Do CFPs have an ethical obligation to contract in the best interests of their clients? The stakeholders include the planner, any clients, other planners, and the larger investment and business communities, as well as the public generally. There may be ethical codes issued by trade and business associations to which a CFP belongs that stipulate the obligation. Religious and philosophical sources include maxims to act in the interest of others.

The following step of the IDDR approach is a Discussion to suggest actions that might resolve the issue. The strengths and weaknesses of the actions, and the consequences and the effects on the stakeholders, should also be considered. The facts of the Carpenter case indicate that a CFP who would act in the best interests of clients would not recommend an investment in a fraudulent scheme. Further, the CFP should be forthcoming and truthful about the nature of any investment—particularly its risk and whether there exists any conflict of interest, such as a commission payable to the CFP for selling it. Such advice could erode a CFP’s income by dissuading clients from choosing investments that might be more profitable to the planner. Ultimately, however, this could increase the level of trust among all of the parties and attract more clients, leading to greater income.

The next step of the approach is to state a Decision and its reasons. It appears that if CFPs were to observe an ethical obligation to contract in the best interests of their clients, benefits could be realized by the planners, their clients, other planners, the investment and business communities, and the public. The planners could obtain more business. Other planners might similarly benefit from the enhanced ethics of their occupation. Their clients might invest more funds with more confidence. The investment and business communities would clearly be enriched by an increase in the number of investors and dollars. The public would benefit from an improved business climate and economic growth.

The final step of the approach is a Review of the success or failure of the action to resolve the issue, and satisfy the stakeholders. A CFP who is forthcoming and truthful about the nature of any investment with clients would likely fulfill an ethical obligation to act in their best interests. This could also satisfy the other stakeholders.

Critical Thinking and Writing Assignments

1. **Time-Limited Group Assignment—Contracts.** Review the basic requirements for a valid contract listed at the beginning of this chapter. Now consider the relationship entered into when a student enrolls in a college or university. (See *Elements of a Contract*.)

1. One group should analyze and discuss whether a contract has been formed between the student and the college or university.

Solution

The relationship between a college or university and its students is con­tractual. Under this contract, the University agrees to provide the students with a worthwhile education and the stu­dents agree to perform financially (by paying their tuition and other fees), academically (by doing what they are asked to do to follow a course of study), and behaviorally (by obeying the school’s rules and regulations).

2. A second group should assume that there is a contract and explain whether it is bilateral or unilateral.

Solution

Under a unilateral contract, once performance has occurred, the con­tract is formed. Students might argue, for example, that their contract with their school is unilateral—once their tuition is paid at the beginning of a semester, their obligation under the contract is complete, but the school has yet to fulfill its promise to provide the semester’s education. But students’ obligations are not ful­filled simply by paying tuition. The relationship between a school and its students is ongoing throughout a semester—in other words, students do not fully per­form their contract simply by paying tuition. Their contract with their school is thus bilateral, not unilateral.

3. The third group will consider the documents that each of you signed when enrolling in college. Did you read and understand the provisions? Would the plain meaning rule apply even if you did not understand some parts?

Solution

Yes. The plain meaning rule applies even if one of the parties to a contract does not understand some of the language. It is the responsibility all individuals who enter into a contract to be satisfied that they comprehend its terms.

Questions can be asked, terms can be negotiated, language can be added or cut, and phrases can be changed before the final agreement. If the language is clear and unequivocal, a court will enforce according to its plain, ordinary, obvious meaning as determined from the face of the instrument. A contract is bound to divine the intent of the parties and to give effect to the deal according to this principle.

Of course, if a party does not understand a term because it is ambiguous, a court can interpret and apply it against the party who drafted the contract. This may occur if the term is subject to more than one reasonable interpretation, there is uncertainty about it, or the intent of the parties cannot be determined from the language.