Chapter 7

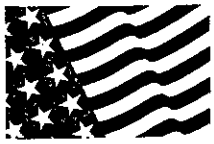
How Contracts Arise

In this unit you will meet the Novak family. Mr. Novak is a widower with four teenage children: Juleanne, 18; Jake, 16; Jennifer 15; and Jarod, 13. He owns a letterpress print shop near their apartment building. Mr. Novak has just returned home from work.

Jake: *Hey, Dad! Your advertisement is in the lost-and-found section of tonight's newspaper.*
Mr. Novak: *(Taking the newspaper from Jake.) I certainly hope it does some good. If I don't get that metal type back, I'll lose that contract I have with the Literary League.*
Juleanne: *Dad, you put our telephone number in the advertisement!*
Jarod: *He had to put the number in the advertisement so everyone looking for the type can call us and tell us that they're out there working for us.*
Jennifer: *Nobody is going to call us and tell us they're looking for the type! All they have to do is show up at our front door with the type and Dad owes them $50. Right, Dad?*
Mr. Novak: *I suppose so.*
Juleanne: *But what if they do start calling? I might miss my call from Bill.*
Mr. Novak: *Bill? Who's Bill? I thought your steady was Gary.*
Jarod: *Juleanne has a new steady every week. Last Friday she hid out in Mary Beth's apartment so she wouldn't have to go out with Ted like she promised.*
Mr. Novak: *Ted? Who's Ted?*
Jake: *Ted is the guy who's going to sue her for breaking last Friday's date.*
Juleanne: *Oh, Jake! I hope Ray sues you for selling your CD player to Eddie.*
Mr. Novak: *You sold your CD player to Eddie? I thought you offered it to Ray.*
Jake: *Eddie offered me more money.*
Mr. Novak: *But you had a contract with Ray.*
Jake: *Not really. I told him I'd sell it to him if he could come up with the cash by noon. He couldn't and I didn't.*
Jennifer: *(Taking the newspaper from her father.) Hey! Look at the picture in this advertisement. This is exactly how I want my hair cut. This is an offer to make me look beautiful for just $10.*
Jarod: *You don't need a hairdresser to make you look beautiful.*
Jennifer: *Thanks, Jarod.*
Jarod: *You need a plastic surgeon.*
Jake: *Not even a plastic surgeon could help her!*
Jennifer: *You just wait. I'll make sure you can't use your car.*
Mr. Novak: *Wait a minute. Jake, you don't own a car.*
Jennifer: *He will if he comes up with the $500 to pay Mr. Johnson for his junker.*
Mr. Novak: *What happens if Mr. Johnson does the same thing to you that you did to Ray and sells the car to someone who offers him more money?*
Jake: *He can't because I was smart. I paid him $10 to hold the offer open 'til Saturday. That's an option contract. I learned that in business law.*
Jennifer: *If there's a buck in it, Jake will learn how to make it.*

New Terms

contract, p. 92
valid, p. 93
void, p. 93
express contract, p. 94
implied contract, p. 94
bilateral contract, p. 94
unilateral contract, p. 94
offer, p. 95
acceptance, p. 97
counteroffer, p. 97



The Spirit of the Law

To be able to conduct business and personal affairs, people must rely on each other's promises. Contract law developed to support and enforce promises that people make in reliance on the promises or acts of others. A contract gives reasonable assurances to all parties that the agreements will be fulfilled. The law provides remedies for those who suffer losses due to others' failures to keep contractual promises.

Legal Issues:

1. Does the offer of a reward for return of lost property create a contract?
2. Is a newspaper advertisement an offer?
3. When does a contract legally come into existence?
4. Is an option contract legally binding?

Elements of a Contract

Many people think of contracts as long and hard-to-read documents. While some contracts do fit this description, it is not an accurate picture of contracts in general. In fact, a **contract** is any agreement enforceable at law. Most of us have already made hundreds of contracts. We enter into contracts every time we buy something new at the store, rent a videocassette, or join a CD club. Contracts are very much a part of our everyday lives. However, to fully appreciate the nature of contracts, we must understand the elements that make up a contract.

We already know that a legal liability or duty is composed of certain elements. In Chapter 2, we saw that criminal liability was composed of two elements: the criminal act and the required mental state. In Chapter 4, on tort law, we saw that liability for negligence required four elements: duty, breach of duty, proximate cause, and actual harm. Contract law follows the same pattern. Six elements make up a contract: offer, acceptance, genuine agreement, capacity, consideration, and legality. To be legally complete, a contract must include all six elements. If any one is missing, a contract does not exist. Notice that the list of six elements does not include a writing. This is because not all contracts have to be in writing to be enforceable.

The first two elements of a contract are offer and acceptance. An *offer* is a proposal by one party to another intended to create a legally binding contract. An *acceptance* is the unqualified willingness to go along with the offer. If a valid offer is met by a valid acceptance, the third element, *genuine agreement*, arises. There are some circumstances, such as fraud, misrepresentation, or undue influence, that could destroy the genuineness of the agreement.

The fourth element, *capacity*, is the legal ability to enter a contract. The law makes a general assumption that anyone entering a contract has capacity. This assumption, however, can be disputed.

The fifth element, *consideration*, is the exchange of things of value that creates the bond between the parties to the contract. In the opening vignette, Jake teases his sister Juleanne by saying that Ted will probably

sue her for breaking their date. However, a social agreement, such as Juleanne's date with Ted, would not be a contract because the consideration is missing. Consequently, Juleanne is in no danger of being sued by Ted.

Finally, people entering contracts cannot be permitted to agree to do illegal acts. For this reason we say that contracts must be legal. *Legality*, then, is the final element of a contract. Figure 7-1 below summarizes the six elements of a contract.

Elements of a Contract

Element	Description
Offer	A proposal made by one party (the offeror) to another party (the offeree) indicating a willingness to enter a contract.
Acceptance	The agreement of the offeree to be bound by the terms of the offer.
Genuine Agreement	Offer and acceptance go together to create genuine agreement, or a meeting of the minds. Agreement can be destroyed by fraud, misrepresentation, mistake, duress, or undue influence.
Consideration	Consideration is the thing of value promised to the other party in a contract in exchange for something else of value promised by the other party. This mutual exchange binds the parties together.
Capacity	The law presumes that anyone entering a contract has the legal capacity to do so. Minors are generally excused from contractual responsibility, as are mentally incompetent and drugged or drunk individuals.
Legality	Parties are not allowed to enforce contracts that involve doing something that is *illegal*. Some illegal contracts involve agreements to commit a crime or a tort. Others involve activities made illegal by statutory law.

Figure 7–1 To be legally complete, a contract must include these six elements. What happens if one of them is missing?

Characteristics of a Contract

Contracts have certain characteristics or qualities that fall into four categories. A contract may be

- valid, void, voidable, or unenforceable;
- express or implied;
- bilateral or unilateral; and
- oral or written.

Any one contract could have a characteristic from one or more of these four groups. That is, a contract could be valid, express, bilateral, and written. Let's take a closer look at what these characteristics indicate about a contract.

Valid, Void, Voidable, Unenforceable

The word **valid** means legally good. Thus, a valid contract is one that is legally binding. On the other hand, the word **void** means having no legal force. A void contract, then, amounts to nothing and has no legal effect whatever. An agreement missing one of the six elements previously discussed would be void. For example, an agreement to do something illegal would be void.

When one party to a contract is able to void or cancel the contract for some legal reason, that contract is labeled "voidable." A voidable contract

then, is one that is not void in itself, but it may be voided by one of the parties if that party chooses. For example, a contract between a minor and an adult may be voided by the minor, but not by the adult.

A contract may be unenforceable because of some rule of law that cannot be enforced in court. For example, a statute of limitations is a rule of law that states that, after a certain time lapse, a person can no longer bring a given legal action. Suppose that a plaintiff has waited too long to bring suit, allowing the statute of limitations to run out.

> ***Example 1.*** On March 17, 1991, Trevor Martin agrees to buy Natalie Anderson's CD collection for $410. The agreement is never put in writing. Anderson is to deliver the CD's on March 20 and Martin is to make payment on March 25. Anderson fulfills her part of the deal, delivering the CD's on March 20. Martin, however, does not pay on March 25 as agreed. He pleads financial hardship. Anderson refuses to extend the time period. Martin continues to refuse to pay. After many attempts to either collect the money owed or repossess the CD's, Anderson files suit on March 25, 1996. In Anderson's home state, the statute of limitations for enforcement of contracts for the sale of goods is four years. The statute began to run on March 25, 1991, the day Martin refused to pay, resulting in the injury to Anderson. Since five years have passed, Anderson's contract is unenforceable.

Express, Implied

An **express contract** is stated in words and may be either oral or written. The contract in Example 1 is express, even though it was not put in writing. An **implied contract** is one that comes about from the actions of the parties. Very often people enter into implied contracts without exchanging a single word.

> ***Example 2.*** Herb Schneider drives into a self-service gas station that requires payment before the attendant will turn on the pumps. Schneider walks into the station and hands the attendant a ten-dollar bill. He returns to his car and pumps $10 worth of gas into the tank. He then drives off. Throughout the entire incident neither party spoke a single word, yet an implied contract arose by their actions.

Bilateral, Unilateral

The word bilateral means two-sided. A **bilateral contract** contains two promises—one by each person. One person promises to do something in exchange for the other person's promise to do something. If a friend says to you, "I'll sell you my VCR for $150," and you say, "I'll buy it," a bilateral contract comes into existence. You and your friend have made promises—you have promised to buy and your friend has promised to sell. Most contracts come about this way.

In contrast, the word unilateral means one-sided. A **unilateral contract** contains one promise only. One person promises to do something if and when the other person performs some act. If your friend says to you, "I'll sell you my VCR for $150 if you give me the cash before noon tomorrow," only one person is making a promise—the one promising to sell. That person will not be required to keep the promise unless you hand over the cash before noon on the following day. If you deliver the money within the time limit, a unilateral contract will take effect. Figure 7-2 on page 95 illustrates the difference between a unilateral and a bilateral contract.

LAW & Ethics

You offer to sell Joe your car for $500 if he pays you by Saturday. On Friday, Bill offers you $600 for the car, and you accept. Joe shows up on Saturday with the $500. Ethically, should you have held the car for Joe? Why or why not?

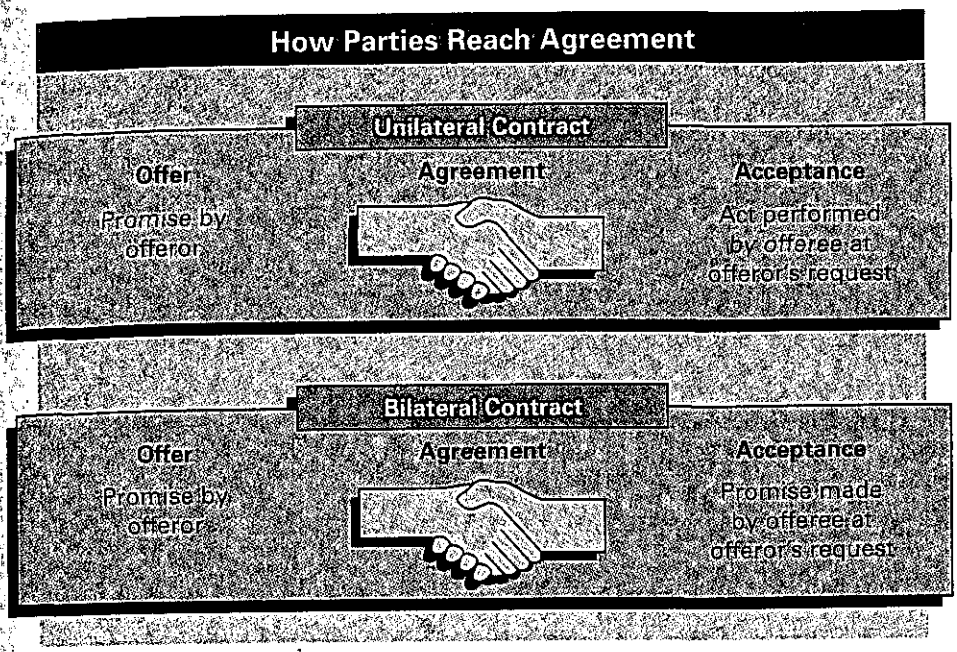


Figure 7-2 A contract may be unilateral or bilateral. In which type of contract do both offeror and offeree make promises?

A reward offer is one of the most common instances of this kind of contract. The acceptance of the reward offer must precisely comply with the offer.

> ***Example 3.*** In the opening vignette, Mr. Novak placed an advertisement in the local newspaper, offering a reward for the return of his lost metal type. In answer to Legal Issue 1, placing the advertisement offering a reward in the newspaper does not create a contract. The contract would not come into existence until someone returns the type. At that point, Mr. Novak will owe the finder $50.

Oral, Written

An oral contract is created by word of mouth. It comes into existence when two or more people speak to each other. One person usually offers to do something, and the other person accepts and agrees to do something else in return. Most contracts that we make are of this type.

Sometimes, however, it is desirable to put contracts in writing. A contract is put in writing to allow the parties to know the exact terms of the contract and to provide proof that the agreement was made. A law known as the Statute of Frauds requires that certain contracts must be evidenced by a writing to be enforceable. We will learn more about this in Chapter 12.

Requirements of an Offer

A valid offer is the first of the six elements that creates a contract. An **offer** is a proposal by one party to another party to enter into a contract. The person making the offer is the *offeror*. The person to whom the offer *is* made is the *offeree*. An offer has three basic requirements: (1) it must be seriously intended, (2) it must be definite and certain, and (3) it must be communicated to the offeree.

Serious Intent

An offer must be made with the intention of entering into a legal obligation. An offer made in the heat of anger or as a joke would not meet this requirement. For instance, a friend complaining about her unreliable car might say, "Give me five bucks and it's yours." In such cases, words are used that sound like an offer when, actually, no offer is seriously intended.

Very often, an invitation to negotiate is confused with an offer. Sellers normally have limited merchandise to sell. They could not possibly sell the advertised product to everyone who saw the advertisement. Not only would they not have enough products to go around, but they also might be unable to obtain more of the same product to satisfy the demand. For this reason, most advertisements in newspapers, magazines, and catalogs are treated as invitations to negotiate rather than offers. They are also called invitations to deal, invitations to trade, and invitations to make an offer.

> *Example 4.* An advertisement that appeared in the evening newspaper read, "Teenage Mutant Ninja Turtle Action Figures, $7.98." Carole Lauretig walked into the store at noon the next day and said, "I accept your offer on the Teenage Mutant Ninja Turtle Action Figures." The clerk apologized, saying that the figures had sold out within an hour after the store had opened.

The advertisement was merely an invitation to the public to come in, see the action figures, and make an offer. When Carole said, "I accept your offer," she was actually making an offer to buy the action figures at $7.98 each. The store owner could accept or reject the offer.

In the opening vignette, Jennifer declares that the newspaper advertisement by the hairdresser is an offer to make her look beautiful for $10. In answer to Legal Issue 2, most of the time a newspaper advertisement is not an offer; it is an invitation to trade. There are exceptions to this rule. Advertisements are sometimes held to be offers by the courts when they contain very particular promises, use phrases such as "first come, first served," or limit the number of items that will be sold. In such cases, under the terms of the advertisement, the number of people who can buy the product becomes limited, making the advertisement an offer rather than an invitation to negotiate.

Price tags, signs in store windows and on counters, and prices marked on merchandise, in addition to advertisements, are treated as invitations to negotiate rather than offers. This rule of law probably stems from days when people negotiated for products in the marketplace more than they do today. The price marked on the item is the starting point for the bargaining that may occur between the buyer and the seller before the final price is decided.

YOU And The LAW

To what person or agency in your local area or state would you go for help in enforcing a contract? Is there a special department that handles contracts with minors?

Definiteness and Certainty

An offer must be definite and certain to be enforceable. In a case in which the landlord agreed to pay "a share" of the cost if the tenant fixed the plumbing, the court would not enforce the contract because it was too indefinite. It was impossible to determine what the parties meant by the word "share." Similarly, in a case in which a person agreed to buy equipment at "competitive prices," the court said the words were too indefinite for the contract to be enforceable.

Example 5. Joe Vasquez was offered a position as an account executive with the International Corporation. He was to receive $2,400 a month plus a "reasonable" commission on total sales. Is this a definite and certain offer? It is not because it would be difficult to determine exactly what a "reasonable" commission is. The court, however, could fix a commission based upon general practices of the trade.

Communication to the Offeree

Offers may be made in many ways—by telephone, by letter, by telegram, by fax machine, or by other methods. To be effective, an offer must be communicated to the offeree.

Example 6. Jean Lefevre found a wallet. A driver's license in the wallet identified the rightful owner. Lefevre returned the wallet. The owner thanked her but did nothing more. Later in the evening, while reading the local newspaper, Lefevre discovered that the owner had offered a reward for the return of the wallet. Can Lefevre recover the reward? No, she cannot legally collect the reward. The offer had not been communicated to her. She did not know about the reward at the time that she returned the wallet, so it cannot be said that the offer was communicated to her.

Reducing Legal Risks

When you make an offer: Make sure it is subject to only one possible interpretation. Specify a time and manner of acceptance. Be definite and clear about terms of the offer and any conditions that apply.

Requirements of an Acceptance

The second element of a legally binding contract is the acceptance of the offer by the offeree. **Acceptance** is the unqualified willingness to go along with the offer. As in the case of an offer, there are certain basic requirements for an acceptance. These include making the acceptance unconditional and following the rules regarding the method of acceptance.

Unconditional Acceptance

The acceptance must not change the terms of the original offer in any way. This principle is called the *mirror image rule.* As its name suggests, this rule requires the acceptance to "mirror" the offer. Any change in the terms of the offer means that the offeree has not really accepted the offer. Rather, he or she has made a **counteroffer.** If a counteroffer is made, the original offeror is not obligated to go along with that counteroffer and no contract results. Instead, it is up to the original offeror, who is now an offeree under the counteroffer, to accept or reject the counteroffer.

Example 7. Art Clifford sends a letter to Marge and Norm Grayson offering to buy their home for $80,000. The Graysons, who had advertised the house at $85,000, send a written reply to Clifford which states, "We accept your offer. However, we would like the price set at $83,000."

The Graysons have not accepted Clifford's offer, despite their use of the words, "We accept your offer." They have made a counteroffer. At this point, Clifford is free to accept or reject that counteroffer. He may also make a counteroffer of his own. For example, he could agree to purchase the home for an amount of somewhere between $80,000 and $83,000. Then the initiative to accept or reject would shift to the Graysons. This process could continue until the terms of the offer and the acceptance "mirror" each other. Or the three of them may decide that they will never be able to agree on a mutually satisfactory price. The same type of interchange is also often seen

when a sports star and the team's owners go back and forth negotiating salary terms or when a union and management are renegotiating a collective bargaining agreement.

Contracts for sale of goods are exceptions to the mirror image rule. They include contracts for personal property such as clothing, furniture, foodstuffs, motor vehicles, appliances, and so on. The primary exceptions are created by the Uniform Commercial Code (UCC). The UCC is a unified set of statutes that covers the law of sales as well as other areas of commercial law. It was drafted in 1952 to make trade among the states easier. The UCC has been adopted with minor variations by 49 states. Only Louisiana has not adopted all of its provisions.

FYI

Louisiana is the only state that has not adopted the UCC in its entirety. The UCC is based on English common and commercial law. Louisiana's law, however, is based on French civil law. The United States bought the Louisiana Territory from France in 1803. The French civil law was called the Code Napoléon, after France's leader, Napoleon Bonaparte.

One UCC exception involves non-merchants. Non-merchants are those who neither regularly buy or sell goods nor claim to be experts on the goods. In non-merchant situations, the offeree may make minor changes and a contract will still be created. For example, if someone says to you, "I'll sell you my camera for $150," and you answer, "I'll buy it and pay you next week," a contract is created. The added term, "I'll pay you next week," may be accepted or rejected by the offeror. Remember, this rule allowing minor changes to be made applies only to goods.

A second exception involves sale-of-goods contracts between merchants. When both parties are merchants, the additional or different terms become a part of the contract. This applies only if the following conditions are met: (1) the new or different terms do not make a material or crucial difference to the nature of the contract, (2) the offeror does not object to the new or different terms within a reasonable time, and (3) the original offer did not expressly limit acceptance to the terms in that original offer.

Methods of Acceptance

The time at which an acceptance takes effect is very important. At that precise moment, as suggested by Legal Issue 3, the contract comes into existence. When the parties are dealing face to face or on the telephone, no special problem exists. One party speaks; the other hears him or her and communicates the offer or the acceptance. When the parties are separated by great distances, however, and must write letters, send telegrams, or use a fax machine, special rules indicate when an acceptance takes place.

When the offeree uses the same method of communication that the offeror used, the contract comes into existence when the acceptance is sent. Let's assume that Bradley and Franz live in different cities. Bradley has made an offer by letter to sell his motorcycle to Franz. Franz decides to accept. No contract exists as of yet. Franz writes a letter, places it in an envelope, addresses the envelope to Bradley, and places a stamp on it. There is still no contract. He carries the letter to a post office mailbox, pulls down the slide, puts the letter in, but holds his finger on the letter. He still has not accepted and the contract has not yet come into existence. When he finally lifts his finger and lets the letter slide into the mailbox beyond his control, the contract is made.

In contrast, if the offeree uses a method of communication that is different from that used by the offeror, the contract comes into existence when the acceptance is received. This rule applies to contracts for real estate and services. For sale-of-goods contracts under the UCC, the acceptance takes

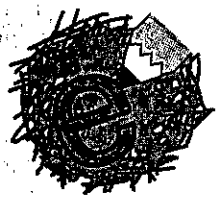
place when it is sent, as long as the method of communication is reasonable under the circumstances. This would mean that the acceptance of a mailed offer for goods would be effective when it is sent via a private overnight carrier, such as Federal Express or United Parcel Service, or when it is placed in a fax machine and sent electronically to the offeror.

If the offeror states in the offer the method that the offeree must use to accept, that method of acceptance must be followed. Bradley could have stated the time and place of acceptance in his offer, indicating that a contract would not come into existence until he received the acceptance. In that case, a contract would come *into* existence only if Bradley received the acceptance within a specified period of time.

Sometimes an offer specifies that it must be accepted by an action. When this is true, the action must take place before there is an acceptance. Thus, if Larry McNulty promised to pay Floyd Little $50 if Little would march with the band at halftime in a gorilla suit, Little would have to do so in order to accept the offer.

The offeror cannot impose silence on the offeree as the means of acceptance unless the offeree has previously agreed to such a condition or unless the offeree has allowed his or her silence to be construed as acceptance in past dealings with that particular offeror. In contrast, if the offeror has set up silence as the means of acceptance, then he or she will have to live by that condition if the offeree accepts by remaining silent.

Law and Language



Origin of Legal Terms

Many legal terms have their origin in Latin. For example, the verb *contract* is derived from the Latin *con*—with or together—and *trahere*—to draw or pull. Thus, to contract is to draw something together, such as the terms for a business deal.

Legal terms often include a root word derived from Latin. Adding a Latin prefix to the beginning of a word completely changes that word's meaning. For example, a contract may be unilateral or bilateral. The root word, *lateral*, is derived from the Latin *lateralis*—relating to a side. Adding the Latin prefix *uni*—one or single—results in a word describing a contract that obligates one side, or party, to act. Adding the Latin prefix *bi*—two or double—results in a word describing a contract that obligates two parties to act.

The word *illegal* is another example of the change a prefix can make. The root word *legal*, meaning lawful, is derived from the Latin *lex*—law. Adding the prefix *il*—not—results in a word with the opposite meaning. Thus, illegal means "not lawful."

Adding a suffix to the end of a word can also change a word's meaning. For instance, a contract involves an offeror and an offeree. The root word, *offer*, is derived from the Latin *offerre*—to present. Adding the suffix *or*—a person or thing that does something—results in a word describing the person who makes an offer. Adding the suffix *ee*—recipient—results in a word describing the person to whom an offer is made.

These examples represent only a sample of the Latin words that make up the base for terms used in the legal system of the United States. Clearly, the Latin language is a significant part of that system.

1. What is the difference between unilingual/bilingual; unicycle/bicycle; legible/illegible; literate/illiterate?

2. How is a promisor different from a promisee? A grantor from a grantee?