Elements Of A Contract

The validity of a contract is governed by three principles: (1) mutual agreement through the process of offer and acceptance, (2) consideration and (3) a capacity to contract.

(1) Offer and acceptance. An offer (which must have certain and definite terms showing an intention to make a promise or undertake a commitment) is generally valid until accepted or rejected by the person to whom the offer is made or withdrawn by the person making the offer. Generally, to accept an offer the acceptance must be a mirror image of the offer, including any relevant terms of the offer; otherwise, it is a counter-offer. When accepting an offer, the offeree should notify the offeror. If a time period for acceptance is not specified, the offeree should notify the offeror. If a time period for acceptance is not specified, an offer may terminate (a) by change of circumstance (e.g., a property offered for sale has been sold), (b) after a reasonable period of time, (c) due to the death or incapacity of a party (unless the offer provides otherwise), (d) if the subject matter of the offer is destroyed, or (e) by operation of law (e.g., a law is passed prohibiting the sale of a certain product).

(2) Consideration. Consideration is the inducement or motive to enter into a contract and must be a bargained for exchange (between the contracting parties) of some legal value (i.e. a return promise, performance, or tender of cash). The amount of the consideration does not have to be substantial, so long as it is negotiated and agreed to by the parties. In most circumstances, it is valid consideration to exchange a promise for another promise; there needs to be some benefit to the person making the promise. For instance, mutual consideration exists if a person promises to mow your lawn and you promise to pay $10 for that service. If, however, the consideration is of little to no value, it may be a gift and not consideration sufficient to find a contract exists.

(3) Capacity. Although certain limited exceptions exist, generally a party entering into a contract must have the legal capacity to do so. In most states, the age of majority is 18 years. The parties must also be able to understand the nature and significance of the contract. If a party is entering into a contract on behalf of a business entity, that party must have the corporate authority to bind the corporation.

Note: A contract must be for a legal purpose. Illegal contract terms and contracts against public policy are unenforceable and void. Similarly, unconscionable contracts (where there is an inequality in bargaining power or coercion and unfair terms) may be of limited enforcement or voided.

When Is A Written Contract Required? It is normally recommended that you put all agreements in writing but in some instances it is required. These requirements frequently impact business owners:

(1) Transfers of land, easements, mortgages or deeds of trust, and leases with regard to land/real property that will last more than three years.
(2) Promises to lend money.
(3) Debts of another (guarantor or surety), except in very limited circumstances (main purpose doctrine).
(4) Sale of goods for a price of $500 or more (governed by the Uniform Commercial Code or “UCC”).
(5) Leases of personal property (e.g., a computer, a copier) exceeding $1,000.
(6) Non-compete covenants.

Note: Certain other contracts, not listed above, must also be in writing.
Specific Types Of Contracts:
The types of contracts listed below are specialized, and it is always recommended that you consult a lawyer to advise you based on your particular circumstances.

(1) Commercial leases. In addition to meeting any writing and recordation requirements, make certain that the space is defined with a high level of specificity (attaching a legal description as an exhibit, if possible). Other terms to consider include: how rent is due and payable, what happens if you do not pay on time, how rent escalates, what the term is, how a party can renew or terminate, any rights related to security deposits, who is liable for payment of utilities, property taxes, and insurance (and for what coverage at what coverage limits), whether there are “common area,” operating, or maintenance obligations or costs, whether you have all the access and parking you need specified, what alterations or improvements can be made and by whom under what circumstances, what happens if there’s a fire, other casualty, or the space becomes condemned, safety and security requirements and costs, whether you can assign or sublet the space, whether the landlord mortgage it or transfer it, any broker fees, how default is defined, who is responsible for environmental compliance, what signage is permitted and at what cost and what your obligations are when terminating the space and any improvements made or fixtures installed. Also make sure there is a “quiet enjoyment” provision and that the landlord’s right of entry is reasonable. If you are subletting, ensure that the sub-landlord can sublet the space and have the master landlord agree in writing.

(2) Contractor agreements. If you chose to employ independent contractors, attention must be paid to whether you are treating the independent contractor as an employee. If so, you may be found responsible for compensating that person with the types of benefits afforded to your employees. The IRS has set forth certain factors to consider with regard to how work is performed by an independent contractor that can be used as a guide. The list of factors can be found online (www.irs.gov). Consult with an attorney if you are uncertain. Improper classification can lead to liability under wage and hour laws and personal liability for withholding taxes among other liabilities.

(3) Employment agreements. An employment agreement can establish obligations of confidentiality and non-disclosure, protection of trade secrets, issues of ownership arising out of the work-for-hire doctrine, non-compete covenants, and limitations on outside employment or investing. Unless you want to modify the North Carolina rule that employment is “at will,” make certain that you clearly and conspicuously provide that employment remains at will, is at the mutual consent of the employer and the employee, and may be terminated by either party at any time, with or without notice or cause. Consider stating expressly that you have the sole right to modify, amend, terminate or otherwise alter, at any time with or without notice, at your sole discretion, any terms regarding salary/wages, job title/description, or benefits offered. Also consider whether an employee handbook more appropriately meets your needs.

(4) Purchase Orders/Confirmations. In addition to meeting any writings requirements, consider whether there are competing terms between forms such as purchase orders and confirming documents received. In certain circumstances, any inconsistencies may be resolved by agreement between the parties, which will avoid the confusion and cost associated with a “Battle of the Forms.”