Creating a Contract

DEVELOPMENT OF CONTRACT LAW

People have entered into agreements for thousands of years. Before the development of a monetary system, people would barter for goods and services. As societies progressed, so did commerce. Agreements became more sophisticated and money became the medium of exchange. Such were the beginnings of contract law.

Commerce around the world today could not function without contracts. Contracts range from buying lunch at your favorite fast food restaurant to developing an upscale high-rise condominium complex in an urban setting. As contracts became more complex, so did the laws governing contracts, including the development of the Uniform Commercial Code.

But, what exactly is a contract? Black's Law Dictionary, 5th Ed., defines a contract as follows:

**Contract.** An agreement between two or more persons which creates an obligation to do or not to do a particular thing.

Read the following articles:

- **Contracts**, including the imbedded links, presented by Wex, a collaboratively-edited legal dictionary and encyclopedia sponsored and hosted by the Legal Information Institute at Cornell Law School. (http://topics.law.cornell.edu/wex/contract)


Contract law is generally state law. Each state has its own particular definition of a contract.
CLASSIFICATION OF CONTRACTS
Contracts can be classified in several different ways:

- **Express Contract**
  An express contract is a contract in which the contracting parties expressly state the terms of the contract, either orally or in writing.

- **Implied Contract**
  An implied contract is a contract which is implied or inferred by the actions or conduct of the parties, without being expressly stated.

- **Bilateral Contract**
  A bilateral contract is a contract in which each contracting party makes a promise to the other contracting party.

- **Unilateral Contract**
  A unilateral contract is a contract in which one contracting party makes a promise to the other contracting party in return for an act by the other party.

- **Executory Contract**
  An executory contract is a contract in which one or both contracting parties are required to perform some act in the future. The contract is not yet completed.

- **Executed Contract**
  An executed contract is a contract that has been fully performed by both contracting parties and nothing remains to be done by either party. The transaction is complete.

- **Valid Contract**
  A valid contract is a contract that fulfills all the requirements of a contract and is enforceable.

- **Unenforceable Contract**
  An unenforceable contract is a contract that is otherwise valid, but cannot be enforced, because fails to meet a certain requirement for that type of contract. For example, certain contracts, such as contracts for the sale of land, must be in writing to be enforceable.

- **Void Contract**
  A void contract is a contract that is void and without legal effect from its attempted creation. An example of a void contract is a contract to commit a crime.

- **Voidable Contract**
  A voidable contract is a contract that is enforceable, but can be avoided by one or both of the contracting parties. An example of a voidable contract is a contract entered into by a mentally incompetent person.

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**OFFER + ACCEPTANCE + CONSIDERATION = CONTRACT**

Under the common law, three elements are necessary to create a contract:

1. Offer
2. Acceptance
3. Consideration

**OFFER**

The term *offer* has been defined in slightly different ways by courts and state legislatures. Black's Law Dictionary, 5th Ed., provides several definitions of an offer, including the following:

*Offer*, *n.*...A promise, a commitment to do or refrain from doing some specified thing in the future. The offer creates a power of acceptance permitting the offeree by accepting the offer to transform the offer's promise into a contractual obligation.

More simply stated, an offer is a promise made by the *offeror* (the person making the offer) to do something, or not to do something.

**Elements of an Offer**

To be effective, the offeror must have *present intent* to make an offer. In addition, the terms of the offer must be:

1. Definite and certain
2. Communicated to the *offeree* (the person receiving the offer)

**Present Intent.** The offeror must have present intent to make an offer that can be accepted to create a contract. At times a person may make a statement that appears to be an offer, but does not intend it to be an offer. An example is a person who is merely joking. If Otto Mobile, who is frustrated with car exclaims, "I'll sell this car to the first person that gives me $5!" such a statement is not a real offer.

In cases where it is difficult to determine whether a person intended to make an offer, the court will apply the "objective standard" test. The court will hold that statement is an offer, if a "reasonable person," who objectively reviews the statement and the surrounding circumstances, would believe that the offeror intended to make an offer.
Definite and Certain. The offer must be definite and certain. It must sufficiently identify the subject of the offer and the terms of the offer. The offer must be so certain that the offeree need only say "I accept!" to create a contract. "I offer to sell you one of my boats," is not an offer. It is neither definite nor certain, because it does not identify which boat is to be sold, nor state the purchase price that the offeror would accept to create a contract.

Communicated to the Offeree. The offer must also be communicated to the offeree. If the offeror merely thinks about making an offer, then it is not an offer. Likewise, if the offeror tells someone that he is intends to make an offer, but does not communicate it to the offeree, then no offer has been made.

Termination of an Offer
No contract is created if an offer is terminated prior to its acceptance. An offer may terminate by the action (or inaction) of the parties, or by operation of law.

Termination by the parties action/inaction
An offer is terminated if:

1. The offeree rejects the offer.
2. The offeror revokes the offer before it is accepted by the offeree.
3. The offer expires according to its terms.
4. The offeree fails to accept the offer within a reasonable time.

An offeree may terminate an offer by rejecting it. An offeror may terminate an offer, in many cases, by revoking it before it is accepted by the offeree. Generally, the offeror's revocation is not effective until it is received by the offeree.

Exceptions:

Option Contract. An offeror may not revoke an offer if the offer has entered into an option contract. An option contract is an agreement in which the offeror has agreed to "hold the offer open" for a certain period of time in exchange for some payment by the offeree. For example, Mary Millionaire, who owns an office building, offers to sell the building to Bob Buyer. Bob does not currently have funds to purchase the building, but would like time to obtain financing. The parties agree to enter into a real estate option contract, in which Mary and Bob agree that in exchange for Bob's payment of $5,000 to Mary, Mary gives Bob an option to buy her building for $500,000, if Bob tenders (delivers) the money to Mary within 90 days. Under the terms of this option contract, Mary may not revoke her offer for 90 days. If Bob tenders the agreed purchase price to Mary within that time period, she must sell him the building. If Bob fails to tender the purchase price to Mary within the 90 days, Mary's offer terminates.

Unilateral Contract. Generally, an offeror may not revoke an offer for a unilateral contract (a contract requiring offeree's act as acceptance), if the offeree has started performance. If a court allows an offeror to revoke an offer for a unilateral contract prior to the offeree's full performance, the court may order the offeror to compensate the offeree for any benefit that the offeror received from offeree's partial performance. For example, if Howard Homeowner offers to pay Pat Painter $500 to paint Howard's house
and then Howard revokes the offer when Pat is only half finished painting the house, the court in one state may prohibit Howard from revoking the offer, while a court in another state may allow Howard to revoke the offer, but order that Howard pay Pat for the reasonable value of painting half of Howard's house.

**Firm Offers.** Under the Uniform Commercial Code (UCC) a **firm offer** by a **merchant** (a person in the business of selling the contract item) to sell **goods** (personal property governed by the UCC) may not be revoked, if the offer is written and contains assurances by the merchant that the offer will remain open. Section 2-205 of the UCC provides:

§ 2-205. Firm Offers. An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

*Note:* The UCC is a model code that states have adopted with modifications. As a result, the foregoing section may be different in different states.

An offer may also terminate if it is not accepted by the deadline for acceptance stated in the offer. If an offer does not have a deadline for acceptance, it may terminate if it is not accepted by the offeree within a **reasonable time.** What is considered a reasonable time depends upon the circumstances. For example, a reasonable time to accept an offer to buy bananas is much shorter than a reasonable time to accept an offer to purchase office furniture.

**Termination by operation of law**

An offer may also terminate before acceptance by **operation of law,** including:

1. Either the offeror or offeree die or become mentally incompetent.
2. The subject matter of the offer (the contract item) is destroyed.
3. A law is passed after the offer, but before acceptance, that would make the contract illegal.

An offer terminates if either the offeror or offeree dies or becomes mentally incompetent before the offer is accepted by the offeree. (Neither person has the capacity to enter into a contract.) Destruction of the subject matter of the contract before the offer is accepted also terminates the offer. For example, if Mary Millionaire offers to sell her office building to Bob Buyer, but the building burns down before Bob accepts, the offer is terminated. Finally, an offer is terminated if a law is passed before acceptance that would make the contract illegal. If Joe Gambler offered to sell gambling machines to Big Bucks Casino, but the state legislature then passed a statute prohibiting gambling prior to Big Bucks' acceptance, the offer would be terminated.
**ACCEPTANCE**

An offer must be accepted by the offeree to create a contract. If an offer is not accepted, then no contract is formed. Once an offeree accepts an offer, the offeree cannot change or withdraw the acceptance.

- **Elements of an Acceptance**
  To be effective, an acceptance must be:

  1. An unequivocal and unconditional acceptance, without material changes to the offer
  2. Communicated to the offeror (unless the offer requires the performance of an act)

**Unequivocal and Unconditional.** The acceptance must accept the offer unconditionally, without changes. The offeree may not put conditions on the acceptance. For example, the offeree may not say, "I accept your offer, if you lower the price by $100." The requirement that the acceptance match the offer is called the "mirror image rule." The acceptance must "mirror" the offer. If an offeree attempts to accept the offer with changes, the offer terminates and the offeree attempted acceptance is deemed to be a *counteroffer*. If an counter offer, the parties switch sides. The original offeree is the offeror and the original offeror is offeree.

**Communicated to the Offeror.** The offeree must communicate the acceptance to the offeror. If the offer does not require a particular manner of communication, then the offeree may communicate the acceptance using any reasonable method. Generally, if an offer requires that the acceptance be communicated by a certain method (such as a requirement that the acceptance be written and sent by certified mail), then the acceptance must comply with such terms to be effective. In such case, the acceptance is effective when it is mailed. If an offeree attempts to communicate acceptance through an unauthorized method, then the acceptance is not effective until it is received by the offeror, prior to revocation of the offer.

*Exception:* An acceptance of a unilateral contract need not be communicated to the offeror. An offer for a unilateral contracts requires the performance of an act by the offeree to accept the offer. For example, an offerer may offer to pay a reward for the return of a lost item. In a unilateral contract, the offeree must perform the act, rather than merely communicate his acceptance.

**CONSIDERATION**

Consideration is the final necessary element of a contract. An offer and acceptance does not create a contract without consideration.

- **Elements of Consideration**

  Consideration must be:

  1. A bargained for exchange
  2. Have legal value
Bargained for Exchange. The parties to a contract must exchange something as consideration for the contract. A promise that is not supported by consideration is not a contract. It is simply a promise. The parties to a bilateral contract exchange a promise for a promise. The parties to a unilateral contract exchange a promise for an act. A pure gift is not consideration, because it was not given in exchange for something.

Legal Value. The consideration for a contract must have legal value. Legal value is not the same as economic value. Legal value can be:

1. Promising to do something that a person is not required to do.
2. Promising not to do something that a person is entitled to do.

Alan Account can enter into a contract by promising to provide accounting service to a business. Because Alan is not required to provide such service, his promise has legal value. However, if Alan's daughter, Suzy, promised Alan that she would not exceed the speed limit when driving to and from school, such a promise would not have legal value, because Suzy has a pre-existing legal duty to drive safely and not to exceed the speed limit.

Promising not to do something also has legal value. If Alan Account made a mistake in his accounting service, his client could bring a lawsuit against him to recover the amount of money lost by Alan's mistake. However, Alan and his client could enter into a contract in which the client agreed not to exercise his legal right to sue Alan, in exchange for Alan's payment of an agreed amount of money to compensate the client for Alan's mistake.

Read the article, What is "Consideration" and How Much is Required?, (http://smallbusiness.findlaw.com/business-forms-contracts/business-forms-contracts-overview/business-forms-contracts-overview-consideration.html)

Equitable Theories

Contract law requires that certain requirements be fulfilled before a contract is created. Unfortunately, transactions are not always simple. A situation may occur where a person entered into a transaction in good faith and conferred a benefit upon another person, only to find that a valid, enforceable contract had not been formed. Rather than allow the other person to profit from the lack of a contract, a court may use equitable theories of quasi-contract and promissory estoppel to prevent injustice.

Quasi-Contract

If an injustice would result, a court may impose a quasi-contract ("like a contract"), to provide the "innocent" party with the reasonable value of the thing sold, or services conferred, upon the other party.

Promissory Estoppel

Promissory estoppel occurs when a person makes a promise to another person that he should reasonably expect would cause the other person to act or forebear from acting, and which does in
fact cause such action or forbearance, and injustice would occur unless the promise was enforced.

Read the article addressing equitable remedies, entitled When Will a Promise or Statement Be Considered a Binding Contract? (http://smallbusiness.findlaw.com/business-forms-contracts/business-forms-contracts-overview/business-forms-contracts-overview-binding.html)

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**CONTRACT LAWS**

As previously mentioned, contract law is generally state law. Each state has its own particular definition of a contract.

Review the statutes of your state, or a state of your choice, that define:
- Offer
- Acceptance
- Consideration

Statutes are available online at the Cornell University Law School Legal Information Institute. (http://www.law.cornell.edu/states/listing.html)

Ask your instructor for assistance, if you have difficulty locating the statutes.

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Read the following case and any other cases assigned by your instructor.

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**GERAETS v. HALTER**

1999 SD 11, 588 N.W.2d 231 (1999)

AMUNDSON, Justice

Patrick and Michael Geraets appeal from a trial court judgment finding no enforceable contract on the sale of real property. We affirm.

**FACTS**

Patrick (Pat) and Michael (Mike) Geraets operated as a partnership known as "Geraets Brothers." Ernest and Ethel Halter owned land that the Geraets rented. Prior to the transaction in question, Ernest had always dealt with the partnership, Geraets Brothers, and not with either Pat or Mike individually.

On September 2, 1997, Mike Geraets and Ernest discussed the sale of Halter's land. A price of
$750 per acre was agreed upon and the two decided to go to Ernest's attorney, Glen Eng, to draw up the necessary papers. On the way to Eng's office, Mike phoned Pat regarding the purchase of the land. Ernest was advised the brothers would be purchasing the land together.

When Ernest and Mike arrived at Eng's office, it was determined Mike and Pat were undecided as to the division of the land to be purchased. Attorney Eng advised the parties he would wait to draw up two offer and purchase agreements until the Geraets had decided how they wanted to split the land. A contract for deed would be drafted after the purchase agreements were received back, along with a $500 down payment.

On September 19, 1997, Mike and Pat contacted Eng with the information on how they wanted to split the land. Eng drew up the purchase agreements and the Halters signed them. Eng subsequently sent out two separate offer and purchase agreements signed by the Halters to Mike Geraets.

Neither Eng nor the Halters received any word back until October 22, 1997. In the interim, Ernest frequently stopped by Eng's office to inquire whether he had received any response. On October 22, Ernest stopped at Pat's home to ask about the status of the agreements. Pat was not available, but Ernest spoke with Pat's wife. Pat's wife informed Ernest that Mike had injured his back and he was contemplating quitting farming. Furthermore, Pat and Mike were considering dissolving their partnership.

The following day, October 23, Ernest and Pat spoke on the telephone. Pat informed Ernest that Mike was no longer interested but he (Pat) would take the land himself. Pat testified Ernest replied that he would "just as soon deal with one person." Ernest testified the one person he had in mind was the Geraets Brothers. Following the phone conversation, the same day, Ernest went to visit Pat. Ernest testified he told Pat at that time he did not want to go through with the sale. Pat testified that Ernest had only mentioned he was unsure what he wanted to do with the land.

On October 28, at approximately 1:00 p.m., Ernest went to Pat's home and told him "the deal was off." Ernest also told Pat he was not going to sell the land for anything less than $1,000 per acre. Ernest then went to Eng's office to advise him he no longer wished to sell. That same day Eng sent two letters, one to Pat and one to Mike, stating that the Halters had withdrawn the offer.

At some point near the end of October, Mike decided to allow Pat to purchase all of the property and gave him a copy of his purchase agreement. Pat crossed out Mike's name and signed both agreements. On the morning of October 28, Pat placed both agreements in his mailbox at the end of the driveway.

On October 29, Eng received the signed purchase agreements and earnest money check from Pat. The Halters refused to sell.

Pat and Mike, brought an action seeking specific performance to compel the Halters to sell the land according to the agreements notwithstanding Mike's assignment to Pat. The trial court denied specific performance, finding no contract. Geraets appeal, raising the following issues:
1. Did the trial court err in holding that the "Offer and Purchase Agreement" documents that had been signed by the Halters were not contracts to sell, but only offers to sell?

2. Did the trial court err in holding that Michael Geraets could not assign to Patrick Geraets his interest in the "Offer and Purchase Agreement" for which Michael Geraets was the designated purchaser?

3. If the signed "Offer and Purchase Agreement" documents were merely offers to sell, did the trial court err in holding that the Halters effectively revoked their offer prior to acceptance by the Geraets?

4. Did the trial court err in holding that the Halters were the "prevailing parties" entitled to an award of disbursements under SDCL 15-17-37 even though a money judgment was entered in favor of the Geraets on an alternative count for unjust enrichment?

**STANDARD OF REVIEW**

A trial court's findings of fact will not be disturbed unless they are shown to be clearly erroneous. Talley v. Talley, 1997 SD 88, ¶19, 566 NW2d 846, 851; Jasper v. Smith, 540 NW2d 399, 401 (SD 1995); Knudsen v. Jensen, 521 NW2d 415, 418 (SD 1994). Under this standard, findings will not be disturbed unless, after a review of all the evidence, we are firmly and definitely convinced a mistake has been made. *Talley*, 1997 SD 88, ¶19, 566 NW2d at 851; Cordell v. Codington County, 526 NW2d 115, 116 (SD 1994). Conclusions of law are reviewed *de novo*, giving no deference to the trial court's determinations. *Id.*

**DECISION**

1. **Whether there was an enforceable contract.**

Under SDCL 53-1-2, the elements necessary for formation of a contract are:

- (1) parties capable of contracting;
- (2) their consent;
- (3) a lawful object; and
- (4) sufficient cause or consideration.

Parties must be identifiable. SDCL 53-2-3. The trial court found the parties' initial negotiations did not constitute a contract because the critical element of who the buyer was had not been resolved. This information was later provided to attorney Eng and the purchase agreements were prepared for the parties to sign. The Halters signed the purchase agreements. The issue whether or not this was a final and complete agreement was contested at trial.

At trial, Mike Geraets testified: "I didn't know if I wanted to go through with the purchase at that time[,]" Pat testified, "when he [Ernest] called me I told him that Mike had hurt his back, and that we were wanting to buy the land, but we didn't know for sure who would take over that
portion of Mike's[.]" The trial court reasoned: "If a contract had been reached, there's no discussion of who the buyer is, it's already bought. [I]f they have already reached a contract he [has] already bought, so he obviously did not believe that a contract had already been reached."

"An agreement is the result of a mutual assent of two parties to certain terms, and, if it be clear that there is no consensus, what may have been written or said becomes immaterial." Watters v. Lincoln, 29 SD 98, 100, 135 NW 712, 713 (1912) (citation omitted). "Consent is not mutual unless the parties all agree upon the same thing in the same sense." SDCL 53-3-3. Ensuing negotiations evidence absence of intent that the purchase agreement constitutes a final and complete agreement. See Sabow v. Hall, 323 NW2d 861, 863 (SD 1982) (finding no final and complete agreement where negotiations between parties continued after offer and purchase agreement were signed); cf. Rusch v. Kauker, 479 NW2d 496, 500 (SD 1991) (finding a contract where the purchase agreement contained all necessary terms and conditions and any remaining negotiations involved the contract for deed).

While the Geraets contend the entire time they intended to purchase the land, their conduct showed otherwise. "Whether a contract is formed is judged objectively by the conduct of the parties, not by their subjective intent. The question is not what the party really meant, but what words and actions justified the other party to assume what was meant." Crince v. Kulzer, 498 NW2d 55, 57 (MinnApp 1993) (citations omitted). The evidence showed a delay from September 19, 1997, when the purchase agreements were received, until October 28, 1997, when the agreements were finally signed and placed in the mail. During this time, the evidence showed the Geraets themselves were uncertain as to the future of their partnership and whether the land would be purchased and, if so, who would purchase it. When Ernest finally went to visit Pat to inquire on the status of the agreements, he was told by Pat's wife that Mike was contemplating quitting farming and the partnership would be dissolved.

Based upon the Geraets own testimony, the trial court determined on-going discussions between Pat and Mike manifested no assent to be bound to a final agreement. Although there are factual disputes, the trial court is in the best position to assess the credibility of witnesses, weigh the conflicting evidence and observe the witnesses and the evidence first hand. Cowan v. Mervin Mewes, Inc., 1996 SD 40, ¶15, 546 NW2d 104, 109; In re Estate of Elliott, 537 NW2d 660, 662 (SD 1995). Upon review of the record, we find substantial evidence to support the conclusion of the trial court that no contract existed. Whenever an agreement has not passed beyond the condition of negotiation, "[a]nd, if it is left doubtful from all the evidence in the case whether a contract was concluded or not, equity will not grant specific relief." Watters, 29 SD at 104, 135 NW at 713. (fn1)

2. Whether the Geraets were prevailing party under statute.

Geraets contend they are the prevailing party. While the Geraets lost the issue of specific performance raised under their complaint, they obtained payment from the Halters for the following: $888 chisel plowing, $468.59 spraying costs and approximately $66 for picking rock. SDCL 15-17-37 allows the prevailing party to recover disbursements. The trial court determined the Halters to be the prevailing party. "The prevailing party is the party in whose favor the decision or verdict is or should be rendered and judgment entered." City of Aberdeen v. Lutgen, 273 NW2d 183, 185 (SD 1979) (interpreting prevailing party under SDCL 15-15-1) (citation
omitted).

The Geraets' original complaint sought the remedy of specific performance to enforce a purchase agreement. Only at the conclusion of trial did the Geraets make a motion for compensatory damages for costs incurred. Halters never objected to the payment of those costs, in fact, they offered to reimburse Geraets prior to this lawsuit. The payment of Geraets' costs was not a contested issue. Therefore, Halters were properly held to be the prevailing parties.

Based on our holding on issue one, we see no need to discuss issues two and three.

We affirm.

MILLER, Chief Justice, SABERS, KONENKAMP, and GILBERTSON, Justices, concur.

Footnotes
1. Geraets argue that Halters, by signing the purchase agreements and sending them to the Geraets, did all that was necessary to create an enforceable contract. See McPherson v. Fargo, 10 SD 611, 74 NW 1057 (SD 1898). This argument presumes there was a final and complete agreement embodying the terms agreed to for the seller to sign. Id. at 1058. In the present case, there never was a final and complete agreement because the parties were of a different mind. Therefore, Fargo is inapplicable.