CHAPTER 10

Entering Into Contracts and Agreements

As a business owner, you'll often have to enter into contracts (legal agreements) with other businesses and people: suppliers, customers, creditors, and landlords, for example. While a few of these transactions will be simple enough to complete with a handshake, most will be sufficiently complicated, long-term, or financially important to require a written contract.

Thankfully—and contrary to what many people believe—a contract is often a fairly simple legal document. It sets out mutual promises to do specific acts: "A promises to pay B $1,000 if B delivers 50,000 twist-ties to A's warehouse on or before March 1, 20xx." A written contract will usually include the main terms of the agreement: the price of goods, important dates, and the time and place of delivery. For most contractual agreements, standard forms are readily available. Except in the relatively few instances in which lots of money or new legal issues are involved, you probably won't need a lawyer to complete your contract.

Simple as some types of contracts may be, you must remember that they are legally enforceable. If you fail to keep your end of the bargain, you can be sued and forced to pay damages to the other party or, in some circumstances, to do the things you promised in the contract.

This chapter explains some contract basics, including what makes a contract enforceable and which contracts are legally required to be in writing.

Contract Basics

Although lots of contracts are filled with mind-bending legal gibberish, there's no reason why this has to be true. For most contracts, legalese is not essential or even helpful. On the contrary, the agreements you'll want to put into a written contract are best expressed in simple, everyday English.

TIP

Don't be afraid to redraft contract language. When reading a contract that has been presented to you, your first task is to make sure you understand all of its terms. It is just plain foolish to sign a contract if you're unclear on the meaning of any of its language. If a clause is poorly written, hard to understand, or doesn't accomplish your key goals, rewrite it to be clear. By refusing to sign at the "X" unless your goals are clearly met, you'll be less likely to find yourself in a breach-of-contract lawsuit later on. A breach of contract occurs when one party fails to live up to the terms or promises in the contract. (For more on changing contract language, see "Reading and Revising a Contract," below.)

Elements of a Valid Contract

A contract will be valid if all of the following are true:

- All parties are in agreement (after an offer has been made by one party and accepted by the other).
- Something of value has been exchanged, such as cash, services, or goods, for something else of value (or there is a promise to exchange an item for something else of value).
- In a few situations, such as the sale of real estate, the agreement must be in writing. (See "Oral Versus Written Contracts," below.) Of course, because oral contracts can be difficult or impossible to prove, it is wise to write out most agreements.

Each of these elements is described below in more detail.

Agreement Between Parties

Although it may seem like stating the obvious, an essential element of a valid contract is that all parties really do agree on all major issues. In real life there are plenty of situations that blur the line between a full agreement and a preliminary discussion about the possibility of making an agreement. To help clarify these borderline cases, legal rules have developed to define when an agreement exists.

The most basic rule of contract law is the "offer and acceptance" rule: A legal contract exists when one party makes an offer and the other party accepts it. For most types of contracts, this can be done either

orally or in writing. (For a few, discussed in "Oral Versus Written Contracts," below, the offer and acceptance must be made in writing.)

Let's say, for instance, you're shopping around for a print shop to produce brochures for your business. One printer confirms, either orally or in writing, that he'll print 5,000 two-color flyers for $200. This constitutes his offer. If you tell him to go ahead with the job, you've accepted his offer. In the eyes of the law, when you tell the printer to go ahead, you create a contract, which means you're liable for your side of the bargain—in this case, payment of $200. But if you tell the printer you're not sure and want to continue shopping around (or don't even respond, for that matter), you clearly haven't accepted his offer, and no agreement has been reached. Or, if you say his offer sounds great, except that you want three colors instead of two, no contract has been made, since you have not accepted all of the important terms of the offer—you've changed one. (Depending on your wording, you may have made a "counteroffer," which is discussed below.)

In real, day-to-day business, the seemingly simple steps of offer and acceptance can become quite convoluted. For instance, sometimes when you make an offer, it isn't quickly and unequivocally accepted; the other party may want to think about it for a while or try to get a better deal. And before your offer is accepted by anyone, you might change your mind and want to withdraw or amend it. Delaying acceptance of an offer, revoking an offer, and making a counteroffer are common situations in business transactions that often lead to confusion and conflict. To cut down on the potential for disputes, make sure you understand the following issues and rules.

- **How long an offer stays open.** Unless an offer includes a stated expiration date, it remains open for a "reasonable" period of time. What's "reasonable," of course, is open to interpretation and will depend on the type of business and the particular situation. Because the law in this area is so vague, if you want to accept someone else's offer, the best approach is to do it as soon as possible, while there's little doubt that the offer is still open. Keep in mind that until you accept, the person or company who made the offer—called the offeror—may revoke it.

  If you are the offeror, it's best to be very clear about how long your offer will remain open. The best way to do this is to include an expiration date in the offer. But to leave yourself room to revoke the offer, avoid wording such as, "This offer will remain open until December 31, 20xx." Instead, use language such as, "This offer will expire on December 31, 20xx."

TIP

Include an expiration date clause. In many types of businesses, from replacing roofs to redesigning websites, it is common to bid (in other words, to make an offer to create a contract) on

Advertisements as Offers

Generally speaking, an advertisement to the public does not count as an offer in the legal sense. In other words, if you advertised your catering services in your local weekly newspaper, and included a price quote of $300 for your standard menu serving 20 people, you would not be legally bound to live up to that service if someone called you and said, "I accept!" If, for instance, you were too busy with other catering jobs and unable to do the job for the eager caller, you could decline. Because your ad wasn't, legally speaking, an offer, the caller couldn't claim a legal acceptance of it to create a binding contract.

Despite this, however, you do need to watch what you say in your advertisements. Some states require retailers to stock enough of an advertised item to meet reasonably expected demand, or else your ad must state that stock is limited.

Of course, false or misleading advertising is always a bad idea. Federal laws regulating trade and state consumer protection laws prohibit deceptive advertising, even if no one was actually misled. And check your ad's facts; false advertising is illegal, even if you believed the ad to be truthful when you ran it.

lots more jobs than you really need or want. But sometimes this strategy can backfire. With lots of offers floating around, there is always the possibility that too many will be accepted, which could raise the embarrassing possibility that you might not be able to deliver on all the work. One easy way to eliminate this problem is to print right on your bid or offer form that all offers are good for only ten days (or some other relatively short period) unless extended in writing.

- **Revoking an offer.** Whoever makes an offer can revoke it as long as it hasn't yet been accepted. This means if you make an offer and the other party wants some time to think it through, you can revoke your original offer. If your offer is accepted while it is still open, however, you'll have a binding agreement. In other words, revocation must happen before acceptance.
- **Options.** Sometimes the offeror promises that an offer will remain open for a stated period of time—and that it cannot and will not be revoked during that time. This type of agreement is called an option, and options don't usually come for free. Say someone offers to sell you a forklift for $10,000, and you want to think the offer over without having to worry that the seller will revoke the offer or sell to someone else. You and the seller could agree that the offer will stay open for a certain period of time, say, 30 days. Often, however, the offeror will ask you to pay for this 30-day option—which is understandable because he or she can't sell to anyone else during the 30-day option period. But payment or no payment, when an option agreement exists, the offeror cannot revoke the offer until the time period ends.
- **Counteroffers.** Often when an offer is made, the other party will not accept the terms of the offer right off, but will start bargaining. Of course, haggling over price is the most common type of negotiating that occurs in business situations. When one party responds to an offer by proposing something different, this proposal is called a "counteroffer." When a counteroffer is made, the legal responsibility to accept or decline the offer or make another counteroffer shifts to the original offeror. For instance, if your printer (here, the original offeror) offers to print 5,000 brochures for you for $300, and you respond by saying you'll pay $250 for the job, you have not accepted his offer (no contract has been formed), but instead have made a counteroffer. It is then up to your printer to accept, decline, or make another counteroffer. If your printer agrees to do the job exactly as you have specified for $250, he's accepted your counteroffer and a legal contract has been formed.

Exchange of Things of Value

Even if both parties agree to the terms, a contract isn't valid unless the parties exchange something of value in anticipation of the completion of the contract. The "thing of value" being exchanged—called "consideration" in legal terms—is most often a promise to do something in the future, such as a promise to perform a certain job or a promise to pay a fee for that job. Returning to the example of the print job, once you and the printer agree on terms, there is an exchange of things of value (consideration): The printer has promised to print the 5,000 brochures, and you have promised to pay $250 for them.

This requirement helps differentiate a contract from generous statements and one-sided promises that are not enforceable by law. If your friend Leili offers you a favor, for instance, such as to help you move a pile of rocks without asking anything in return, that arrangement wouldn't count as a contract, because you didn't give or promise anything of value. If Leili never followed through with the favor, you would not be able to force her to keep that promise. If, however, in exchange for helping you move rocks on Saturday, you promise to help Leili weed a vegetable garden on Sunday, the two of you have a contract.

Although the exchange-of-value requirement is met in most business transactions by an exchange of promises ("I'll promise to pay money if you promise

to paint my building next month"), actually doing the work or paying the money can also satisfy the rule. If, for instance, you leave your printer a voice mail message that you'll pay an extra $100 if your brochures are cut and stapled when you pick them up, the printer doesn't have to respond; he can create a binding contract by actually doing the cutting and stapling. And, once he does so, you can't weasel out of the deal by claiming you changed your mind.

Oral Versus Written Contracts

Before you learn more about which contracts have to be in writing to be legally enforceable, here's some advice: Put all of your contracts in writing. For compelling practical reasons, all contracts of more than a trivial nature should be written out and signed by both parties. Here is why:

- Writing down terms tends to make both parties review them more carefully, eliminating misunderstandings and incorrect assumptions right from the start.
- An oral agreement—no matter how honestly made—is hard to remember accurately.
- Oral agreements are subject to willful misinterpretation by a not-so-innocent party who wants to get out of the deal.
- Oral contracts are sometimes difficult, and often impossible, to prove, making them hard to enforce in court.

EXAMPLE: Kay opens a plant shop called The Green Scene. Because she needs specialized grow-lights for her extensive line of tropical plants, she checks with several contractors who install lighting systems. One company, Got a Light, says it will install a system for $3,000, including the cost of the lights themselves and installation charges. That quote is the lowest among the companies Kay has checked, so she tells Got a Light she'll accept the offer, but only with a written contract.

When Got a Light sends Kay a contract, she notices that it doesn't address rewiring her shop. She calls Got a Light and talks with Dan, who tells her that she needs to have an electrician add several new circuits and provide six specialized outlets before Got a Light can install the lighting system. Based on this discovery, Kay and Dan discuss exactly what needs to be done before Got a Light's work begins and include this new agreement in an additional contract clause. Dan recommends an electrician, whom Kay hires to do the rewiring. She also manages to negotiate a lower price with Got a Light, based on the fact that the rewiring will be done according to Got a Light's specifications, making the installation much easier.

The best advice is to get every contract in writing. Now here's what the law says: All states have laws that require certain contracts to be in writing. These laws often go by the name "Statute of Frauds" and are quite similar from state to state. They typically require the following types of contracts to be in writing.

- An agreement that by its terms can't be completed in a year or less. For example, a contract for a bakery to provide fresh bread to a restaurant for two years must be in writing. On the other hand, if the contract might take longer than a year to complete but could be completed within a year, it doesn't need to be in writing. For example, a contract for a gardener to landscape five big properties would not need to be written, because it is quite possible that the gardener would finish the work within one year. Similarly, a contract for a bakery to bake bread for a restaurant with no time period stated would not need to be in writing.
- A lease for a term (or time period) longer than one year, or an agreement authorizing an agent to execute such a lease on your behalf.
- Any sale of real estate (or of an interest in real estate), or an agreement authorizing an agent to purchase or sell it on your behalf.
- An agreement that by its terms will not be completed during the lifetime of one of the parties. This includes a promise to leave someone your business when you die.

- A promise to pay someone else's debt, such as a business partner's promise to pay your car payments or an agreement that the person who prints your brochure will also pay the cost of photographic work done at another shop.

In addition to the Statute of Frauds laws, each state has a special body of law on commercial issues called the Uniform Commercial Code (UCC). (Although Louisiana has not fully adopted the UCC, it has implemented some of its more important provisions.) Under the UCC, a sale of goods for $500 or more requires at least a brief written note or memo indicating the agreement between the buyer and the seller. The note can be much less detailed than a normal contract; it needs only to show an agreement between the parties and the quantity of goods being sold. Other terms that are typically covered in contracts, such as the price of goods or the time and place of delivery, aren't required. This written memo usually has to be signed, although if one party doesn't object to the memo within ten days of receiving it, then that party's signature isn't required.

Now that you have an idea of which contracts must by law be in writing, it bears mentioning again that, in practice, written contracts are almost always preferable over oral ones—whether legally required or not.

Using Standard Contracts

By now you should understand that your contracts should be written, but you may still have no idea about how to write the ones you'll need. Luckily for you and most other businesspeople, virtually every type of business transaction is covered by a readily available standard contract. Service contracts, rental agreements, independent contractor agreements, contracts for sales of goods, and licensing agreements are just a few examples of blank-form contracts you should easily be able to find.

Anyone who has ever picked up a fill-in-the-blanks lease or promissory note from an office supply store, torn a form out of a self-help law book, or downloaded one from a website is familiar with how

Special State Requirements for Contracts

Various state laws impose additional requirements for contracts involving particular businesses or certain kinds of transactions. In California, for instance, contracts for weight-loss services and dating services must be in writing. Plus, the law requires some contracts to include special language. For example, California dating service contracts must include the following language in at least 10-point boldface type:

> **"You, the buyer, may cancel this agreement, without any penalty or obligation, at any time prior to midnight of the original contract seller's third business day following the date of this contract, excluding Sundays and holidays. To cancel this agreement, mail or deliver a signed and dated notice, or send a telegram which states that you, the buyer, are canceling this agreement, or words of similar effect." (Cal. Civ. Code § 1694.2.)**

Unfortunately, there's no centralized place where a business owner can learn if any special contract laws apply to a particular type of business. Talking with people in your line of business is one option. Another is to do research in a library or online.

If doing legal research to find any required contract language is too time-consuming or overwhelming for you, a good alternative is to use the limited help of a lawyer who's generally familiar with small business issues and, if possible, already works with businesses in your field (other plant nurseries, website designers, or restaurants, for example). Many small business lawyers are now more flexible in offering just as much or as little help as clients need, and offer coaching services to those who want to handle their simple legal affairs themselves. Using a legal coach is especially useful for small business owners, who often need answers to simple legal questions rather than full-blown attorney services. Chapter 16 discusses working with lawyers and finding one who's willing to coach you through simple legal matters.

this works. Blank rental agreements, for example, are widely available at office supply stores, through landlords' associations, at most public libraries, and from many other sources. Once you find the blank-form contract you need, you simply fill it in and, if necessary, modify it before signing.

If you can't easily find a blank-form contract that meets your needs, try the sources described here.

- Trade associations are excellent resources for fill-in-the-blanks contracts.
- Your competitors might be less than willing to share their contracts with you, but similar businesses in faraway locations (which you won't be competing with) might be willing to show you theirs.
- The Web has oceans of information for small businesses, including sample contracts. Try searching for terms particular to your type of business to find specific contracts you need.
- Nolo books offer many different blank-form agreements and Nolo.com includes many single-copy forms such as promissory notes. For general business contracts, two great resources are *Legal Forms for Starting & Running a Small Business,* by Fred S. Steingold and *Quicken Legal Business Pro 2014*.

Once you've found a contract that generally fits your needs, you can amend it for your particular situation. It's entirely appropriate and often necessary to change clauses of a fill-in-the-blanks contract to suit your needs. Of course, it's crucial that you understand what you're doing. Don't just strike a clause because you don't understand what it means or add a clause without fully knowing the consequences of including it. To help you educate yourself about typical contract language, the next section explains which clauses commonly appear in contracts and what they mean.

How to Draft a Contract

If you can't find a form agreement, or if you find one that needs a load of revisions, you may need to write a clause or two—or possibly even the whole contract—from scratch. Don't be intimidated. Either way, your goal is simple: to state clearly what each party is agreeing to do and the specifics of how they'll do it (usually called the terms of the contract). Put another way, your written contract should be the most accurate reflection possible of the understanding you have with the other party.

This section explains the important things to include in most contracts and alerts you to the situations that might require more specialized provisions. The information provided here will help you in editing or drafting amendments to a standard contract, or in drafting a contract from scratch, if necessary. You'll also find examples of how to state certain terms—although, as mentioned above, clear English is really all that's usually necessary.

Good Ideas to Keep Your Contracts Crystal Clear

- Avoid the use of "he," "she," "they," or other pronouns in your contracts as they can easily lead to confusion over what parties you're talking about. Use either the actual names of the parties or their roles, such as Landlord and Tenant. It might seem repetitive or clumsy to write this way, but your goal is to be clear—not to write beautiful prose.
- Stay away from legalistic words such as wherefore, herewith, or hereinafter. Far from making your contract sound more impressive, this type of language is simply unnecessary and outdated. Stick to modern, clear English. And don't include legal expressions you think you may have heard elsewhere. Legal-sounding jargon will not make your contract more binding—and if you get it wrong, you may be bound to terms you didn't want, or your contract may be void.
- Make at least a couple drafts of your contract. After the first draft, let it rest a day or so, and then reread it. Does it leave any questions in your mind? If it does, you need to fill in the gaps with more information.

TIP

Don't get too specific. Although a good contract covers all the important aspects of a deal, you don't need to specify every tiny detail. For instance, if you hire a cleaning service, you probably don't need to specify what type of brushes it will use to scrub your floors. Better to put your energy into picking the right person or company to do the job and to leave some of the specifics of the actual work up to those who will do it. In deciding how much detail is enough, you'll simply have to judge for yourself which nitpicky details are so important that they should be covered in your contract, and which ones you can safely ignore. For example, if you need fresh salmon for a party at 6 p.m., the time of delivery and quality of the fish are extremely important points, but the exact weight of each fish or the method of delivery may be a lot less so.

What to Include in a Basic Contract

So you've reached an agreement with another party and are ready to put it into writing. Before you start editing a form contract or writing one on your own, step back a moment to consider that the goals of all contracts are to:

- clearly outline what each party is agreeing to do (including timelines and payment arrangements)
- anticipate areas of confusion or points of potential conflict, and
- provide for recourse (a remedy) in case the agreement is not followed through to completion.

The more you have at stake, the more carefully you should approach the task of putting together your contract. For example, if you're entering into a contract to buy a truckload of bicycle tires for $1,000, you won't need your agreement to be outlined nearly as meticulously as you would in a contract for the construction of a building.

SEE AN EXPERT

For complex agreements, you may need an attorney. Complex contracts—especially those in areas unfamiliar to you—are often best handled with the help of a lawyer. Certainly, if a transaction is so huge or elaborate that it makes your head spin, you shouldn't go it alone. First, decide how much help you need. Rather than having an attorney draft your contract from start to finish, you could simply have an attorney review a contract that you or the other party has written. Ideally, you should hire a lawyer with some experience with small business, preferably your type of business. Even better would be an attorney who knows the ins and outs of your business based on a long-term working relationship. (See Chapter 16 for more information on getting legal assistance.)

Let's look at the information that most contracts include to fulfill these three goals. Except where noted, you don't need to use any special language.

- **Title.** Generally, a contract will have a simple, to-the-point title such as "Contract for Printing Services" or "Agreement for Sale of Ball Bearings."
- **The names and addresses of all the parties.** It should be clear what role each party has in the contract, such as seller or buyer; landlord or tenant; client or service provider.

  EXAMPLE: Christopher Johnson ("Client") desires to enter into a contract with Virgil's Printing ("Printer") for printing services for Client's newspaper.

  The addresses of the parties generally appear at the end of the contract, in the section with the signatures.
- **A brief description of the background of the agreement (called "recitals").** While not always included, this type of information is often necessary to frame the contents of the agreement. Typically, this section includes a brief description of what kinds of businesses the parties run and the nature of the transaction covered in the contract.

  EXAMPLE: Client prints and distributes a free, weekly, 24-page newspaper called

El Norte with a circulation of 40,000. Printer operates a full-service print shop with three printing presses. The subject of this contract is an agreement that Printer shall print Client's newspaper each week in exchange for payment.

- **A full description of what each party is promising to do as part of the agreement.** This section, sometimes called the "specifications" or just "specs," describes the terms of the deal. If a product is being sold, describe the product and delivery terms. If a service is being performed, describe the job and then state when it will be completed, including any intermediate deadlines that must be met before the final completion date. If strict compliance with deadlines is necessary, throw in the phrase, "Time is of the essence." This is a standard phrase used in contracts. It simply means that deadlines will be enforced strictly.

  If specifications are complicated (for example, intricate performance details for a software contract), they should normally be set out in attachments to the contract, which may include scale drawings, formulas, or other detailed information about the transaction.

  EXAMPLE: Client promises to upload PDF files ("Files") for printing to Printer's server no later than 10:00 a.m. each Wednesday morning. Printer promises to print, fold, and bundle 40,000 copies of Client's newspaper and have them ready for Client to pick up from Printer's shop by 8:00 p.m. that same Wednesday. Time is of the essence regarding this contract. If, however, Client fails to upload Files to Printer by 10:00 a.m. Wednesday morning, Printer may take extra time to complete the job. The amount of extra time will depend on how late Client is in uploading the Files and on Printer's schedule of other jobs, but in no case shall be longer than 24 hours after uploading of the Files.

- **The price of the product or service.** This section states how much one party will pay for the other party's goods or services. If the price may vary (say, based on the time or quality of performance) or if it will be established later, a description of how it will be calculated should be included.

  EXAMPLE: Client will pay Printer $1,000 for every 10,000 24-page newspapers printed, up to 50,000 newspapers. The price will be renegotiated if Client orders more than 50,000 newspapers, or if the number of pages per newspaper changes.

- **Payment arrangements.** This section should explain when payment is due, whether it will be paid all at once or in installments, and whether interest will be charged if payments are late. Also include any other special requirements, such as whether payment must be by certified or cashier's check. Otherwise, a garden-variety check will normally suffice. Again, if strict compliance with payment deadlines is necessary, use the phrase "Time is of the essence."

  EXAMPLE: Client will pay Printer the full amount of each week's printing cost within three days of picking up the completed newspapers.

- **A statement of any warranties made by either party regarding the product or service being provided.** A warranty is essentially a guarantee made by one party to another that a product or service will meet certain standards. If either party gives a warranty, the contract should state what will happen if the guarantee isn't satisfied—for instance, if certain standards aren't met, the party who got the raw end of the deal will be given a refund or may give the other party another chance to do the job right at no additional cost.

Automatic Warranties

Under the Uniform Commercial Code, which is adopted in some form in all 50 states, all sales of products are automatically covered by some warranties whether or not the seller promised anything to the buyer. These warranties are called "implied warranties" and include two guarantees: that the product is fit for its ordinary use and that it is fit for any special purpose for which the seller knows the buyer wants to use it. For example, the sale of a kitchen knife comes with an implied warranty that the knife will work in ordinary kitchen uses. If the buyer asked the retailer to help pick out a knife that would cut through heavy beef bones, then whatever knife the retailer sold would come with a warranty that it would work for cutting heavy beef bones. This is true regardless of whether or not the knife came with an express, written warranty that it could be used for heavy butcher work.

Be aware of the existence of implied warranties when drafting your contracts. Even if you don't make specific promises in your contracts, you will still be legally bound by the two kinds of implied warranties described above: fitness for ordinary use and fitness for a particular purpose. The law regarding warranties can be complex. You may want to consult an attorney for more detailed information about your obligations as a seller.

EXAMPLE: Printer warrants that the completed newspapers shall be free from printing defects or errors attributable to Printer. In case such errors do occur, Printer and Client may negotiate a discount not to exceed actual damages suffered by Client.

- **A statement of whether either party may transfer the contract to an outside party.** Transferring contract rights is also called assigning. If you have chosen a company to provide products or services because of particular characteristics, such as good personal service or artistic detail, you may not want that company to be able to hand off the job to someone else, who may not do as good a job.

  EXAMPLE: Neither Printer nor Client may assign this contract or any part of it to another party.

- **The contract term.** This section, usually only one sentence, establishes how long the contract will be in effect.

  EXAMPLE: This contract will remain in effect for a period of one year, or until it is terminated by one of the parties, whichever is first.

- **A description of any conditions under which either party may terminate the agreement.** For some types of contracts (for example, contracts to provide an ongoing service), a termination clause often states that either party must give a written termination notice in order to end the contract, often 30 or 60 days in advance.

  EXAMPLE: On written notice of at least 30 days to the other party, either Printer or Client may terminate this agreement.

  But you may not want the parties to be able to terminate the contract, even with advance notice, just any old time they feel like it. In this case, you can specify a limited number of certain events that might allow a party to end a contract. For instance, if you want to be able to rely on using your website hosting service for at least a year, you can include a clause in your contract that neither party can terminate the contract for the next 12 months unless either party goes bankrupt, in which case either party would have the right to terminate the contract.

  On the other hand, there may be situations in which you want to be able to terminate a contract yourself. For instance, say you own a

rock shop that sells lots of agate, so you contract with a supplier to sell you a half-ton of agate each month for a year. To protect yourself, you could include a clause in your contract stating that if you resell less than a quarter-ton of agate in any calendar month, you may terminate the agreement.

- **An outline of how you will deal with a breach-of-contract situation.** Though signing a contract may not head off a subsequent dispute, it can channel the dispute in ways that will allow it to be resolved as quickly and cheaply as possible. There are a number of different approaches you can take.

  You can decide, in advance, the amount of damages (financial compensation) a breaching party will have to pay to avoid the often lengthy and contentious process of calculating a party's damages after the other party breaches the contract. When damages are preset in a contract, they are called liquidated damages. In order for a liquidated damages clause to be valid, the dollar amount of damages that you set must be a reasonable estimate of what actual damages would be, not merely a preset penalty for breaking the contract.

  Another option is for both parties to agree in the contract to try mediation and, if that fails, arbitration to settle a dispute as an alternative to going to court.

  EXAMPLE: If any dispute arises under the terms of this agreement, the parties agree to select a mutually agreeable, neutral third party to help them mediate it. The costs of mediation will be shared equally. If the dispute is not resolved after 30 days in mediation, the parties agree to choose a mutually agreeable arbitrator who will arbitrate the dispute. The costs of arbitration will be assigned to the parties by the arbitrator. The results of any arbitration will be binding and final.

  If one or both of you prefers going to court, you can provide in the contract that the losing party in a dispute must pay the other party's legal fees, or you can establish that each party is responsible for individual legal fees regardless of who prevails. Note that for some commercial transactions, neither party in a lawsuit can collect attorneys' fees from the other unless it is provided for in a written contract.
- **For contracts with out-of-state entities, a statement of which state's laws apply to the transaction.** Although contract law in all states is very similar, using the law in your state will generally be the simplest for you, since you'll have more resources at your disposal, including law libraries and local attorneys.

  EXAMPLE: This contract is governed by and interpreted under the laws of New Mexico.

- **Signatures, dates, and addresses.** Your signature section should always include room for the date the contract was signed, as well as the addresses of the parties.

Jennifer F. Mahoney, owner of an illustration service in Northern California:
My creativity is exercised just as much by drawing up a good agreement with a client as it is by the way I create art for that client.

RESOURCE

More on business contracts. For detailed advice on how to write contract provisions, find out what a particular contract term such as indemnity means, or make sure you can enforce important business agreements down the road, see *Contracts: The Essential Business Desk Reference*, by Richard Stim (Nolo).

Putting Your Contract Together

In addition to making sure your contract includes all the necessary information, you'll need to

present it in an easy-to-follow, professional format. Generally, contract clauses are organized in numbered paragraphs for easy reference to specific terms.

If your agreement includes any hard-to-articulate details, such as the specifications of a software product, drawing a company logo, or architectural blueprints, you can include them as attachments to the main contract. If you do include an attachment, be sure to label it and refer to it in the main contract. To officially make it a part of the contract, state somewhere in the main contract that you "include the Attachment in the contract" or that you "incorporate the Attachment into the contract."

EXAMPLE 1: Company agrees to pay artist $100 for use of logo. Logo is attached to this contract as Attachment A and is included in this contract.

EXAMPLE 2: Contractor agrees to complete remodeling within one year. The final plans are attached to this contract as Exhibit B and are incorporated into this contract.

Reading and Revising a Contract

If you don't like certain terms of a contract that's presented to you, you can propose changes. By doing this, you are technically making a counteroffer. Contracts are commonly negotiated back and forth (offer and counteroffer) this way until all the terms are accepted by both parties. Remember, if the parties aren't in agreement, there's no contract—oral or otherwise.

Changes to a contract—whether to a form contract or one drafted from scratch—can be made in a number of ways. You can simply cross out language and fill in new language directly on the contract itself. Both parties should initial any such changes to show that they approve of them, then sign the contract as a whole.

In today's world, however, it's more than likely that there will be an electronic copy of the contract on someone's computer. If so, it makes much more sense to make the necessary changes on the computer and then print out a clean copy for both parties to sign. However some industries (such as the real estate industry) commonly use a separate document when making a counteroffer that states the desired changes and refers back to the original offer. In that case, both the original offer and the counteroffer together form the contract.

A contract can also be amended at a later date with a separate document, called an addendum. The addendum should state that its terms prevail over the terms of the original contract, especially if the terms are in direct conflict, such as when the price or completion time for a job is changed. Both parties should sign the addendum.

Electronic Contracts

While the basics covered so far generally apply to any contract regardless of form—whether the contract is printed in a formal document, scratched on a cocktail napkin, or just spoken and sealed with a handshake—there are new and emerging rules that apply specifically to contracts created online. Before you read the very general overview of the special issues involved in electronic contracts, keep in mind that law in this area is rapidly evolving—scrambling, in fact—to catch up with fast-evolving technology.

What Is an Electronic Contract?

An "electronic contract" is essentially any agreement that is created and executed in electronic form—in other words, no paper or other hard copies are used. Typically, electronic agreements are created either via email or on interactive Web pages. For instance, many companies use interactive forms at their websites that users must complete to purchase goods or software, join a membership organization, participate in a mail listserver, or do whatever else the company is offering. In addition to asking the user to enter various items of personal information, these forms typically display the terms of the contract between the company and the user, and ask the user to agree to the terms by clicking on a button such as "I Accept."

Here's another example of an electronic contract: A business associate of yours emails you a request to purchase a specified number of items you sell, at a named price, for immediate delivery. If you email back to the associate that you agree to all the proposed terms, you've probably just entered into a legally enforceable electronic contract. Why the "probably"? Because there is no way for you to sign the contract with pen and ink, and states vary in how they treat digital signatures. Read on.

Taking Traditional Contract Principles Online

As mentioned above, contract law has only recently begun to grapple with the details of these types of paperless agreements. When electronic contracts have been challenged, courts have had a difficult time determining whether an actual binding contract existed, since it can be unclear whether all the traditional elements of contract formation were met.

Shortcut Contracts for E-Commerce

When it comes to small transactions in which you pay for goods by credit card, most sites get around the issue of whether a valid contract has been formed by saying that if you are dissatisfied for any reason, they will give you your money back. This is another way of saying that if you don't want a contract to exist, it doesn't. Or put another way, the company concedes in advance that it won't try to enforce the contract. This trust-the-customer approach works well for small transactions but has obvious limitations when it comes to major purchases—a car, for example, or significant business-to-business transactions. In these situations, a real signature on an enforceable contract is needed.

Clickwrap Agreements

Businesses have traditionally used standard contracts that aren't open to negotiation; customers have to either accept the contract as is or not complete the transaction. Examples might include a car purchase contract or an agreement to rent a moving truck, in which a consumer who insisted on changing any of the terms of the company's standard contract would not be able to buy the car or rent the truck. Over the years, these types of contracts have been challenged on the grounds that they are not fair to the consumer, because they are typically presented in a take-it-or-leave-it manner, giving the consumer little or no power to amend a contract that is often highly favorable to the seller. Whether or not these types of contracts (sometimes called contracts of adhesion, because consumers are forced to "adhere" to the contract) are valid has long been a contentious area of contract law. Generally, adhesion contracts are held to be valid, as long as the terms are clear to the consumer and not grossly unreasonable.

Today, Internet click-to-agree contracts (often called clickwrap, webwrap, or browsewrap agreements) are facing similar challenges. So are other nonnegotiated agreements, such as the software licenses included with packaged software, sometimes called shrinkwrap agreements. While these types of agreements have generally been found valid, courts have refused to enforce certain terms that are deemed too burdensome or unfair to the consumer.

A federal case decided in 2002 sheds some light on the question of when a clickwrap agreement may be deemed invalid. In that case, an Internet user who downloaded software from a website operated by the Netscape company later sued Netscape, claiming that the software license was not binding. To download the software, the user had simply clicked a "Download" button and was not required to view the software license or click any button such as "I Agree" to indicate consent to license terms. To view the license, the user would have had to scroll below the Download button and click on another link to a separate page where the license terms were posted.

The U.S. Court of Appeals for the Second Circuit ruled in favor of the user, based on the principle that for a contract to be binding, both parties must assent to be bound. The court found that the structure of Netscape's software download page "with license

terms on a submerged screen" and no button to clearly indicate consent was not sufficient to create a binding contract with the user. (*Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. 2002).)

The *Netscape* case establishes that downloading alone does not indicate acceptance of license terms. To make sure a clickwrap agreement is binding, the site must be set up to ensure that a user can clearly indicate consent to the license terms of any downloads. Keep this in mind if you plan to use any clickwrap agreements with your business.

Legislative Attempts to Solve Clickwrap Issues

Over the past several years, there have been a number of state legislative efforts to deal with the issues and problems raised by clickwrap agreements. However, the state laws governing electronic contracts are not consistent, which has actually done more harm than good. And the state courts that have heard and ruled on electronic contract cases have come up with different decisions, with the result that checking an "I accept" box may create a contract in one state, but not in another. No question, this lack of uniformity has been a real thorn in the side of e-commerce, which, of course, recognizes no state boundaries.

In response, the National Conference of Commissioners on Uniform State Laws (NCCUSL) decided to tackle the problem by drafting model legislation for adoption by the states. One of these proposed laws, the Uniform Computer Information Transactions Act (UCITA), addresses the issue of clickwrap and shrinkwrap agreements, essentially making these types of contracts valid and binding.

But in the several years since the UCITA was drafted, hardly any states have adopted it. One reason may be that many consumer advocates, as well as more than 25 state attorneys general, have argued that the UCITA is biased in favor of software vendors and information services providers, leaving consumers with significantly less protection than they have under current law. An online search of the term "UCITA" will lead you to many sites with updated information on the act—and an almost universally negative take on it.

Electronic and Digital Signatures

One of the stickier issues involving electronic contracts has to do with whether agreements executed in a purely online environment have been "signed" (outside of clickwrap agreements, discussed above). For many centuries, the traditional way to indicate your acceptance of contracts (and most other binding documents) has been to sign with your unique signature. But electronic contracts can't be signed this way. Instead, people use other means to indicate they accept the terms of a contract, such as simply typing their names into the signature areas of the documents. But, increasingly, better technological approaches to the problem of signing contracts online are being developed, such as fingerprint or iris scanning, or a cryptographic technology known as Public Key Infrastructure (PKI). These methods are collectively known as electronic signatures. The term "digital signature" refers specifically to cryptographic signature methods such as PKI.

What Is PKI?

Security experts currently favor the cryptographic signature method known as Public Key Infrastructure (PKI) as the most secure and reliable method of signing contracts online. Without going too deep into the technical details, PKI involves using an algorithm to encrypt the document so that only the parties will be able to modify it or "sign" it. The process of encrypting the document is known as creating a digital signature. Each party will have a "key" allowing it to read and sign the document, thus ensuring that no one else will be able to sign it fraudulently. PKI standards are still evolving, but the technology is already widely accepted as the best electronic signature method currently available.

Until relatively recently, most states didn't have any laws stating which of these ways to "sign" an electronic document was legally acceptable. In response, the National Conference of Commissioners

on Uniform State Laws (NCCUSL) drafted another model law, the Uniform Electronic Transactions Act (UETA), which specifically addresses electronic signatures. In a nutshell, the UETA provides that electronic signatures (in all their forms) and contracts are just as valid and legally binding as their paper counterparts. As of late 2013, all states except Illinois, New York, and Washington had enacted the UETA.

Federal Law on Electronic Signatures

Fortunately, as the states were mulling over whether to adopt the UETA, the UCITA, or both, the U.S. Congress forged ahead and passed federal legislation establishing the validity of electronic signatures nationwide. This bill, known as the Electronic Signatures in Global and National Commerce Act, was signed into law in June 2000 and became effective on October 1, 2000. The law applies to all states that had not already adopted the UETA or a similar electronic signature law by mid-2000. In this way, the law finally gave some much-needed consistency to the way states treat electronic signatures in online transactions.

This law is similar to the model UETA in that it makes electronic signatures and contracts (including clickwrap agreements) just as valid as paper ones. While certain transactions are exempted from this law and must still be completed on paper (wills, cancellation of utility services, court orders, and other official court documents, among others), the law allows an enormous range of business and consumer transactions to be completed totally online. In essence, it throws the door wide open for all types of e-commerce, allowing businesses and consumers to create (in theory, at least) reliable, binding contracts online, without the inconvenience of shuttling paper documents back and forth.

Tips for Creating Contracts Online

While the federal e-signature law, along with the UETA, create a solid legal framework for online contracts, electronic signature technology is still evolving, which means the reality of online contracts still falls somewhat short of its promise. Like the UETA, the e-signature law does not specify any particular technology for electronic signatures, leaving that up to software companies and the free market to establish. As mentioned above, Public Key Infrastructure (PKI) technology is currently favored by security experts, though its standards aren't completely nailed down or ready for common use. As developments in PKI and other electronic signature methods create solid, worldwide standards, e-commerce will only become more efficient and widespread.

While waiting for reliable standards to develop, it will be important to approach online contracts carefully. Of particular concern is the possibility for fraud, especially since there is no set standard for what constitutes an electronic signature. Until the technology is airtight, make sure that you trust the other party and are comfortable with the type of electronic signature that you're using. If you're not comfortable creating a contract online, you may want to stay lower-tech and stick with paper contracts, either faxed back and forth or sent by overnight mail.

The nonprofit Consumers Union, which publishes *Consumer Reports* magazine, has issued a set of tips to follow when using electronic signatures and creating online contracts.

- Don't consent to using an online contract if you are uncomfortable using a computer or do not understand how to use email.
- Don't agree to use an online contract or to receive electronic documents until you are sure that your computer's software and hardware will be able to read and use the documents provided.
- Remember that the electronic signatures law allows you to opt to receive documents on paper instead of electronically if you prefer.
- Keep backup paper copies of the electronic documents you receive, and keep a list of the businesses with which you agree to exchange electronic documents.
- Notify the businesses of any changes that may affect your ability to receive and read email

and attachments, such as changing your email address, your hardware, or your software.
- Close any unused email accounts.
- Don't give out your email address to any business if you don't want to receive email notices from it.
- Notify the business right away if you have any problems receiving its emails or opening its documents.

CAUTION

Beware of E-Viruses. Never open attachments to email if you aren't expecting the email or don't know who it's from. Nasty viruses are often spread through email attachments, so it's good policy to just throw away suspicious mail as soon as you see it. Even when you know the sender of the email, you need to be cautious. Some viruses use a computer user's email address book to replicate themselves, by sending themselves out to everyone in the book. This means that if you get an email with an attachment from your friend Steve Smith, there's a chance that Steve Smith didn't actually send the email. For this reason, you shouldn't open attachments unless you're expecting them.

Chapter 10 Checklist: Entering Into Contracts and Agreements

- ☐ Become familiar with the legal basics of contracts.
- ☐ Put all your contracts into writing whenever possible. (Contracts created online or by email are considered to be "in writing.")
- ☐ Try to respond to offers promptly, and, when making an offer, include an expiration date.
- ☐ When you need to draft a contract from scratch, try using standard form contracts to get started.
- ☐ Be thorough in your contracts. Make sure that any points of potential conflict are clearly spelled out.
- ☐ Use caution when entering into electronic contracts (also sometimes called online contracts or digital contracts). If you're uncomfortable creating a contract online or by email, don't do it—opt for a paper contract.