CHAPTER

20

Put It in Writing: Small Business Contracts

As the owner of a small business, it's likely that you'll often encounter both written and oral contracts. The most important piece of advice about contracts is obvious: Put all important agreements in writing. This chapter shows you how, and tells you what to do if something goes wrong.

What Makes a Valid Contract

A valid contract requires two and sometimes three elements:

- an agreement (meeting of the minds) between the parties
- "consideration"—a legal term meaning the exchange of things of value, and
- something in writing, if the contract covers certain matters, such as the sale of real estate and tasks that can't be completed in one year. (See "Must a Contract Be in Writing?," below.)

For example, suppose you're opening a new store. You meet with Joe, a sign maker, to discuss the construction and installation of a five-foot by three-foot sign. Joe offers to do the work for $450 and to have the sign ready for your grand opening on June 15. "It's a deal," you say. You now have a legally binding contract, enforceable in court or by arbitration. All the necessary elements are present:

- **An Agreement.** Joe offered to build and install the sign at a certain price by a certain date. You accepted the offer by telling Joe, "It's a deal."
- **Consideration.** The two of you are exchanging something of value. You're giving your promise to pay $450. Joe is giving his promise to build and install the sign.
- **Written Agreement Not Required Here.** Normal business contracts that can be performed in less than a year don't have to be in writing to be enforceable.

To understand why "consideration" is important, let's explore the difference between a contract and a gift. Assume that Joe installs the sign on time and you pay him $450 as agreed. Impressed by the high quality of his work, you say: "Joe, to thank you for the great job you did, I'm going to send you a $100 bonus next week." Can Joe enforce your promise to pay the bonus? No. He got what he bargained for—the $450 payment. He didn't promise you anything (consideration) for the extra $100 payment. If you pay it, fine. If not, Joe can't force you to.

Negotiations

Negotiations, which may or may not lead to an agreement, do not constitute a contract. Let's say you call Joe and describe the job. He says he can probably do it for about $450. You say, "Thanks, let me think about it." There was no agreement, so you don't have a contract.

Offer and Acceptance

If after negotiations, two people reach an agreement, a contract is formed. Say that after discussing the job with you by phone, Joe promptly sends you a letter in which he says: "I can build and install the sign shown on the enclosed sketch for $450. I'll have it in place by June 15 when you open. You can pay me then." You send back a fax saying: "Sounds good. Go ahead." This is a valid contract. Joe has made a clear offer. You've just as clearly accepted that offer. The fact that you and Joe didn't meet face to face and didn't even use the same type of communication medium doesn't alter this conclusion.

In this example, you accepted Joe's offer promptly. But what if you'd waited two weeks or two months to accept? The legal rule is that an offer without a stated expiration date remains open for a reasonable time. What's reasonable depends on the type of business and the facts of the situation. If you're offered a truckload of fish or flowers, it might be unreasonable to delay your acceptance more than a few hours or even minutes, while an offer to sell surplus wood chips at a time

when the market is glutted might reasonably be assumed to be good for a month or more. But there's really no need to tolerate any uncertainty in this regard. Include a clear deadline for acceptance when you present an offer. If you want to accept an offer, do it as promptly as possible.

Counteroffers

In the real world, negotiations aren't usually as simple as making an offer and having it accepted. And until an agreement is reached, there's no contract.

For example, say Joe sends you the letter offering to provide your sign for $450. You call his office and leave a message on his voice mail saying: "Go ahead, but I can only pay $400." So far, there's no contract. By changing the terms of Joe's offer, you've rejected it and made a counteroffer. The two of you are still negotiating. If Joe calls back and says, "Okay, I'll do it for $400," you now have a binding contract. Joe has accepted your counteroffer. Again, the fact that you and Joe weren't in the same room or never spoke to each other isn't significant. What is key is that one of you made an offer (in this case, in the form of a counteroffer), and the other accepted it.

Revoking an Offer

Until an offer is accepted, it can be revoked by the person who made it. So if you're about to write Joe a letter accepting his offer, and Joe calls to revoke his offer because he's decided $450 isn't enough, you're out of luck. Joe revoked his offer before you accepted it, so there's no contract.

Option to Keep Offer Open

If you want someone to keep an offer open while you think about it, you may have to pay for the privilege. If you do, and the person who made the offer agrees to keep it open, your agreement (which is itself a contract) is called an "option." Options are commonly used when real estate or businesses are sold.

How an Offer to Contract Ends

1. The person who made the offer revokes it before it's accepted.
2. The offer expires.

   EXAMPLE: "This offer will expire automatically if I don't receive your acceptance by noon on May 10." But unless you've been paid something to keep the offer open (as is common for an option to buy real property or a business), you (the offeror) can still revoke the unaccepted offer before the period for acceptance expires.

3. A reasonable time elapses. There are no hard and fast rules as to what's reasonable. It all depends on circumstances and the practices in your industry.
4. The offer is rejected. If you reject an offer and then change your mind, it's too late. To get the deal going again, you'll need to make a new offer to the other party.
5. Either party dies before the offer is accepted.

To stay with our sign example, say that when Joe sends you the letter offering to provide your sign, you tell him you're not ready to respond yet, but you want to be sure the offer will stay open while you think about it. Joe responds that if you pay $100 now, he'll keep his offer open for two more weeks. You pay the $100 and accept the offer within the two-week period. The resulting contract would be valid even if Joe tried to withdraw his offer before the end of the two-week period. You and Joe already have a contract (an option), which consists of your right to purchase his services at the $450 price if you act within the two-week period. He received something of value (your $100) in return for granting you this option.

How Offers Are Accepted

Usually, offers are accepted either in writing or orally. But that's not always necessary. It is an area of considerable legal complexity, but generally an offer can be accepted by a prompt action that conforms with the terms of the offer. For example, you might leave the sign builder Joe a note at his workshop, saying "Please add a red border to this sign today; I'll pay you an extra $100." Joe comes back that afternoon and adds the red border. You're obligated to pay him.

An Advertisement as an Offer

Under traditional contract law, ads are considered only invitations to negotiate or to make an offer; you have no obligation to go through with the deal just because someone offers to meet your advertised price. So if a customer appears and says she wants to buy the house, land, or business that you advertised in the classifieds for $200,000, there's no binding contract. One major exception to this rule involves rewards. Generally, an ad offering to pay a reward is binding if someone performs the requested act.

Consumer protection laws have also changed this traditional rule. For example, the law in many states requires merchants to stock advertised items in quantities large enough to meet reasonably expected demand, unless the ad states that stock is limited. And some states require the merchant to give a rain check allowing the consumer to purchase the same merchandise at the same price at a later date. (See Chapter 17 for more on consumer transactions.)

Unfair or Illegal Contracts

What if a person makes a bad bargain? Suppose you agree to pay $800 for a used laser printer that's worth only $200. Can you call off the deal on the ground that the contract was grossly unfair? Probably not. As long as there's a valid contract, it doesn't usually matter whether or not the item is objectively worth the price paid for it.

Sometimes, however, a court sets aside a contract if the terms are unconscionable—that is, shockingly unfair. For example, a judge or arbitrator may release an unsophisticated consumer (say a recent immigrant with a language problem) from a grossly unfair contract extracted by a sophisticated, high-pressure salesperson. Applying this principle of law, a contract to sell a $500 television for $5,000 might be set aside. But even though a judge might cite contract law, the decision would probably be based more on the doctrine of fraud or misrepresentation. Or the decision might be based on a state consumer protection statute that prohibits taking advantage of someone who can't protect his or her interests because of disability, illiteracy, or a language problem. (See Chapter 17 for more on this type of statute.)

When it comes to reasonably experienced businesspeople working out contracts with each other, however, unfairness is rarely if ever a legal ground for setting aside a contract. Usually, a party who negotiates a bad deal is stuck with it.

If a contract clause is illegal or against public policy, a judge or arbitrator won't enforce it. For example, a remodeling contract stating that neither party will obtain a legally required building permit would be void as a violation of public policy, as would a similar contract obligating a party to bribe a building inspector.

Misrepresentation, Duress, or Mistake

If before you sign a contract the other person tells you a false statement about something important, and you rely on that statement in signing the contract, you can go to court and have the contract rescinded (canceled). This is so even if the other

person doesn't realize that the fact is untrue. For example, say you buy a pickup truck for your business, relying on the seller's assertion that the truck can carry loads up to two tons. It turns out that the seller got the numbers wrong, and the truck can only carry one-ton loads. You can have the contract rescinded. If you have a contract rescinded, you must return any benefits you already received. In this example, you'd have to return the pickup truck to the seller to get your money back.

If you accept "an offer you can't refuse"—because, for example, the offer is made at gunpoint—the contract isn't legally enforceable. The same is true of any other contract made as a result of unlawful threats. For example, if one party threatens to report the other party to the IRS or a state agency if a one-sided contract isn't signed, the contract isn't enforceable.

A mistake is the other ground for rescission of a contract. You thought you were buying a two-year-old computer. The seller thought you were buying her five-year-old computer. If you were both acting in good faith and simply miscommunicated, a judge or arbitrator would probably set aside the contract. But you can't avoid liability if you simply used bad judgment and paid too much for a five-year-old computer that doesn't provide the quality or speed you need.

Breach of Warranty

Sometimes a buyer can return goods to the seller and get a refund based on a breach of warranty. While the practical result in such cases may be the same as setting aside a contract for the reasons mentioned in this section, a different legal concept is at work.

An action for breach of warranty assumes that there's a valid contract. When a buyer seeks a refund based on breach of warranty, he or she is saying: "I acknowledge that we have a binding contract. I want to enforce my rights under that contract for breach of warranty." (See Chapter 17.)

Must a Contract Be in Writing?

Unless a contract falls into one of several specific categories, it is binding even if it's not in writing. You should put all important contracts in writing anyway. Otherwise, you run the risk of a dispute as to exactly what was promised, how much was to be paid, when the contract was to be performed, and on and on. And if you argue so long that you end up in court, it can be somewhere between difficult and impossible (not to mention expensive) to prove the existence and terms of an oral contract.

Contracts That Must Be in Writing

Each state has a statute (usually called the "statute of frauds") listing the types of contracts that must be written to be valid. A typical list includes:

Contracts Involving the Sale of Real Estate or an Interest in Real Estate

Examples are a contract to purchase a building or parking lot or a contract to sell someone the right to use part of your land for a certain purpose (an easement).

FORM

Chapter 7 of *Legal Forms for Starting & Running a Small Business*, by Fred S. Steingold (Nolo), contains forms for buying real estate.

Leases of Real Estate Lasting Longer Than One Year

An example is a three-year lease for retail space in a neighborhood shopping plaza.

FORM

Chapter 6 of *Legal Forms for Starting & Running a Small Businesss*, by Fred S. Steingold (Nolo), contains forms for commercial leases.

A Promise to Pay Someone Else's Debt

This generally involves guarantees of payment. Examples are the president of a corporation personally guarantees to pay for any goods you sell to the corporation; or an uncle guarantees to pay the rent for his nephew's new store.

Contracts That Will Take More Than One Year to Perform

This provision of a "statute of frauds" applies only to contracts that cannot be performed within one year; for example, a contract to provide landscaping services to a hotel for a two-year period.

If performance of a contract is possible within one year, the contract doesn't have to be in writing. How about a contract to plant three maple trees within the next two years? Because the trees could be planted right away, the contract doesn't have to be in writing to be enforceable. Here are several more examples of oral contracts performable within one year (and therefore enforceable):

- A contract to teach four new employees within the next 18 months how to use a software program.
- A contract to cater a total of ten sales banquets for a corporation at dates to be selected by the corporation during the next three years.
- A contract to remove debris from the sites of five new homes to be completed within the next two years.

Contracts for the Sale of Goods (Tangible Personal Property) Worth $500 or More

A contract to sell you a laptop computer for $2,000, for example, must be in writing to be enforceable. If you call a computer store and they agree over the phone to sell you the computer for $2,000 but raise the price to $2,500 when you get there, you don't have an enforceable contract.

Under the Uniform Commercial Code (UCC), however, the written contract doesn't have to state the price or time of delivery—only that the parties agree on the sale of goods and the quantity of goods being sold. And in some cases, if the seller simply sends a written confirmation of an oral order and the buyer doesn't promptly object, a contract has been formed. These UCC exceptions are very important; be sure to read "The Sale of Goods: Special Uniform Commercial Code Rules," below, which explains them in more detail.

There's an important exception to the rule that contracts for the sale of goods worth $500 must be in writing: If an oral contract is partially performed, the whole contract becomes binding. For example, say a salesperson offers to sell you a computer for $2,000 and to throw in a modem when the store gets its next shipment in a week. You pay the $2,000 and take the computer home. When you return to the store the next week to pick up your modem, the store denies that it owes you one. You could sue successfully for breach of contract even though you don't have a written contract for a sale of goods over $500. The reason is that partial performance of the oral contract (your payment and the store's partial delivery of the merchandise) removes the transaction from the written contract requirements in the statute of frauds. Of course, as a practical matter, it would have been better to get the whole deal in writing.

FORM

Chapter 8 of *Legal Forms for Starting & Running a Small Businesss*, by Fred S. Steingold (Nolo), contains forms for buying, selling, manufacturing, renting, and storing goods.

What Constitutes a Written Contract

When state law does require a contract to be in writing, it doesn't mean you need a long-winded document labeled "contract" or "agreement" and signed by both parties. Especially in a business context, judges recognize and enforce writings that contain few details. All that's typically required is a letter, memo, or any other writing signed by the

party against whom the contract is being enforced. The writing must identify the parties and generally describe the subject and the main terms and conditions of the agreement. That's all. The rules for what the writing must contain are even more relaxed for transactions covered by the Uniform Commercial Code, which automatically fills in many missing details. (See "The Sale of Goods: Special Uniform Commercial Code Rules," below.)

I don't recommend that you settle for the bare-bones legal requirements. Because businesspeople's memories—like everyone else's—are imperfect, and because putting a contract in writing tends to highlight erroneous assumptions, and because not everyone you deal with is completely trustworthy, you want important contracts to contain a reasonable amount of detail.

EXAMPLE:

Arnie, a fish shop operator, meets Phyllis, a phone equipment salesperson, at a trade show. Arnie becomes enthusiastic about purchasing a new telephone system for $3,000, which he believes covers the installation, including all wiring and control panels. Phyllis, the sales rep for FoneTek, thinks her company is providing just the phones themselves. If they go ahead on the basis of an oral contract, disaster clearly looms. If, however, Arnie and Phyllis sit down to write up a contract, the issues that haven't really been agreed on are sure to come out, and Arnie and Phyllis will have ample opportunity to make necessary adjustments or call the deal off.

The Sale of Goods: Special Uniform Commercial Code Rules

The Uniform Commercial Code (UCC) contains special rules affecting contracts for the sale of goods. It loosens up the requirements for creating a binding contract when goods are being sold.

The UCC requires you to produce something in writing if you want to enforce a contract for a sale of goods and the price is $500 or more. However, the UCC says that this writing can be very brief—briefer than a normal written contract. Under the UCC, the writing need only:

- indicate that the parties have agreed on the sale of the goods, and
- state the quantity of goods being sold.

If items such as price, time and place of delivery, or quality of the goods are missing, the UCC fills them in based on customs and practices in the particular industry.

CAUTION

Don't rely on sketchy contracts. Just because the UCC makes legal some very sketchy contracts for the sale of goods doesn't mean it's a good idea to routinely use such contracts. It's far better to put together a good written contract. (See "Writing Business-to-Business Contracts," below.)

Remember, if a customer comes to a store, pays for merchandise, and takes it away, there's no need for a formal written contract—the deal is done. (For larger purchases, it makes sense for the retailer to have the customer sign a receipt acknowledging delivery of the goods.) Under the UCC, having some writing is important when the seller merely promises to deliver the goods.

In most situations, the UCC requires that when a contract must be in writing to be enforceable, it must be signed by the person against whom the other party is seeking to enforce the contract. Stated another way, if A wants to sue B for breach of contract and a writing is required, A must show that B signed something showing an intent to be contractually bound.

But when merchants—people who sell goods—are involved, there doesn't always have to be a signed document. If a seller sends a confirmation of an order and the buyer doesn't object in writing within ten days after receiving it, nothing more is required to satisfy the written contract requirement.

Where the UCC Came From

In 1940, someone came up with a brilliant idea: Why not put together a comprehensive code (statute) covering all the branches of commercial law and get it adopted in all states? That way, businesses in Michigan, Illinois, Georgia, or Oregon would all follow the same rules.

It took 11 years to carry out this proposal, which resulted in a set of model statutes called the Uniform Commercial Code, or UCC. Every state except Louisiana has adopted it; Louisiana has adopted key portions of it. The UCC covers these areas of law:

- sales (including warranties; see Chapter 17)
- commercial paper (drafts, checks, certificates of deposit, and promissory notes)
- bank deposits and collections
- letters of credit
- warehouse receipts, bills of lading, and other documents of title
- investment securities, and
- secured transactions.

EXAMPLE:

Nandita owns a retail store that sells shoes. Runner's Choice, Inc., a manufacturer, sends Nandita a notice saying: "This is to confirm that you agreed to buy 1,000 pairs of men's jogging shoes from this company." Under normal written contract rules, this wouldn't be enough to permit Runner's Choice to enforce a contract against Nandita, because she's signed nothing. But under the UCC, if Nandita doesn't object in writing within ten days after receiving the notice, she can't complain about the lack of a written document bearing her signature.

In this example, the notice from Runner's Choice satisfies the requirement that the contract be in writing. But if Runner's Choice sues Nandita for rejecting the shipment of shoes, it will still have to convince the judge or arbitrator that before Runner's Choice sent Nandita the notice, the parties actually reached an oral agreement regarding the shoes. In short, the notice, by itself, is not conclusive evidence that the parties reached a meeting of the minds. A contract signed by both sides is always preferable.

Valid contracts with no writing at all. Where specially manufactured goods are ordered, the UCC says you don't need something in writing to enforce a sales contract if the seller has already made a significant effort toward completing the terms of the contract.

EXAMPLE:

A restaurant calls and orders 500 sets of dishes from a restaurant supply company. The dishes are to feature the restaurant's logo. If the supply company makes a substantial beginning on manufacturing the dishes and applying the logo, the restaurant can't avoid liability on the contract simply because it was an oral agreement.

Checking Out the UCC

Your state laws (statutes) should be available in any law library in your state, in the reference section of many public libraries, and via Nolo's website at www.nolo.com. The Uniform Commercial Code is probably indexed under "uniform," "commercial," or "commerce." Another good Web source is www.law.cornell.edu/uniform/ucc.html. For most small businesses, the section on sales (Article 2) is the most helpful part of the UCC. The UCC changes fairly often; be sure you have the latest version that's been adopted in your state.

Writing Business-to-Business Contracts

Whatever your business, you'll need to write contracts from time to time. You'll probably need a written contract if you want to:

- buy or sell goods
- perform services as an independent contractor or consultant
- lease real estate or equipment
- manufacture, distribute, or license products
- enter into joint ventures
- grant credit, or
- advertise.

Checklist of Contract Clauses

The content of a contract depends, of course, on the type of transaction you're getting into. The checklist below includes items to consider when you draft a contract.

Additional Requirements for Specialized Contracts

Many states require specific provisions in contracts that cover certain types of transactions. Areas where special requirements are likely include:

- sales of new and used vehicles and mobile homes
- home improvement services
- motor vehicle repairs
- apartment and home rentals
- door-to-door sales, and
- funerals, burials, and cremations.

If you're in one of these regulated businesses, you not only need to use a written contract—you also need to make sure it conforms to your state's legal rules. Among other things, you may have to put certain information or warnings in type of a certain size, including a statement about the customer's right to cancel the deal under certain conditions. In some states, you may have to print the contract in Spanish as well as English.

EXAMPLE:

In Michigan, a statute requires a funeral director to insert the following language in boldface type in every prepaid funeral contract:

> "This contract may be canceled either before death or after death by the buyer or, if the buyer is deceased, by the person or persons legally authorized to make funeral arrangements. If the contract is canceled, the buyer or the buyer's estate is entitled to receive a refund of __% of the contract price and any income earned from investment of the principal less administrative or escrow fees."

How to Design Your Contracts

You need contract forms that reflect the specialized nature of what you do, be it creating software, selling produce, publishing books, or cleaning buildings. This is especially true if your business is subject to consumer laws that require specific contract language. Typically, you'll need several basic types of contracts for your business, each with spaces to fill in the details of the specific transaction.

EXAMPLE:

Brian is setting up a direct mail consulting business. He plans to work with local businesses to show them how to stay in better contact with customers by announcing sales, new merchandise, and seasonally extended hours. Brian needs a contract that covers what he'll do, when he'll do it, what he expects his small business clients to provide, warranties, responsibilities for proofreading and signing off on mailings, and payment.

Brian will also need to hire independent contractors, graphic designers, artists, and

Checklist of Contract Clauses

- ☐ **Names and addresses of the parties.**
- ☐ **Date that the contract is signed.** (See "Signing Your Contracts," below, for suggestions about signing a contract.)
- ☐ **A short preamble ("recitals").** This provides some of the background of the agreement. For example, a contract might recite that Discs Unlimited is a retailer of compact discs and has three stores in the metropolitan area; that Stewart has an inventory management business; and that Discs Unlimited wishes to retain Stewart as an independent contractor to establish and maintain the company's inventory control system.
- ☐ **What each party is promising to do.** Pay money, provide a service, sell something, build something, or so on. Often this section of the contract—particularly if it involves a product or a construction project—is labeled "specifications." In many situations, such as designing software, constructing a building, or providing consulting services, the specifications require lengthy attachments that may include drawings, formulas, or charts. (See "Attachments to Contracts," below, for more information.)
- ☐ **When the work will be done or the product delivered.** If strict compliance with contract deadlines is important, be sure to include the phrase: "Time is of the essence." Otherwise, a judge may allow reasonable leeway in enforcing the deadlines.
- ☐ **How long the contract will remain in effect.**
- ☐ **The price—or how it will be determined.**
- ☐ **When payment is due.** Will there be installments, and will interest be charged? In contracts for consulting and other services, it's common to have a payment schedule tied to interim completion deadlines. For example, a contract for architectural services might provide for payment of one-third of the architect's fees when drawings and specifications are finished and approved; one-third after bids have been received on the construction project and a contract signed with the general contractor; and one-third when the project is completed and a certificate of occupancy is issued by the building department.
- ☐ **Warranties.** If one party guarantees labor and materials for a certain period of time, what steps will be taken to correct warranty problems?
- ☐ **Conditions under which either party can terminate the agreement.**
- ☐ **"Liquidated damages" if performance is delayed or defective.** In cases where actual damages for breach of contract would be difficult to compute, the parties can establish in advance a fixed dollar amount (called liquidated damages) to be paid by a party who fails to perform its contractual obligations properly. (See "Enforcing Contracts in Court," below.)
- ☐ **Whether or not either party can transfer (assign) the contract to another person or company.** A contract that allows assignment of contract rights may be okay if it involves just the right to receive money, but not if it means that some other, unknown party will wind up performing skilled services called for by the contract.
- ☐ **Arbitration or mediation of disputes.**
- ☐ **Whether or not a party who breaches the contract is responsible for the other party's attorney fees and legal costs.**
- ☐ **Where notices of default or other communications concerning the contract can be sent.** Typically, the notices are sent to the parties' business headquarters.
- ☐ **What state law applies if questions about the contract arise.** If the parties have operations in different states or the contract will be performed in more than one state, you may avoid potentially knotty legal issues by specifying which state law applies.

computer wizards to help him carry out his contracts, so he'll also need a basic "work-for-hire" contract. Finally, Brian plans to use his experience to develop customized software for sale to similar businesses and so will need a basic software licensing agreement.

If you're new to your business, start by gathering copies of contracts used by other people in your field. Some kinds of contracts, such as commercial leases, are widely available. For other kinds, you may have to dig a bit. Trade associations, which commonly publish material containing sample contracts, are one good source. Other people in your line of work may be willing to share their contracts with you. Form books published for lawyers are an excellent starting point for developing your own specialized contract. Talk to the librarian at any major law library to find some suitable books. (See Chapter 24 for tips on finding and using a law library.)

Once you find a simple contract that's more or less suitable, make sure that you understand every word. Obviously, contracts written in plain English are better than those filled with legalese—but if the latter type is all you can find, it may not be too difficult to rewrite it. Next, write a rough draft of any additions you may need.

CAUTION

Professional help. If you plan to use a form contract for major transactions, consider reviewing it with a lawyer who has small business experience—ideally, one who knows something about your field. It can help you see whether or not the contract does what you want it to do and includes everything you need. Because you have done most of the work, your adviser's advice should be reasonably priced. (See Chapter 24 for how to hire and work with a lawyer.)

Attachments to Contracts

It's common to use attachments (often called exhibits) to your contract to list lengthy details that don't fit neatly into the main body of the contract. For example, in drawing up a contract with a sign maker, you could attach a sketch of the sign and a list of detailed specifications, including materials to be used. Simply refer in the main contract to Attachment A or Exhibit A and note that you "hereby incorporate it into your contract." By referring to the attachment in the contract itself, you make it a part of the contract.

If you're a consultant or routinely contract for your services, consider using a short basic contract and then adding your performance specs in an attachment. That way you can use the same basic contract form over and over with only slight modifications.

RESOURCE

Here are some books that can help you make your own contracts:

Materials Written Primarily for Individuals

- *101 Law Forms for Personal Use*, by Robin Leonard and Ralph Warner (Nolo). This book, which includes promissory notes and agreements to sell, lease, and store property, also contains contracts for service providers (such as child care providers and home repair contractors) that are of use to small businesspeople in these fields.

Materials Written Primarily for Businesspeople

- *Legal Forms for Starting & Running a Small Business*, by Fred S. Steingold (Nolo). This book, accompanied by a CD-ROM with sample forms and agreements, will make it easy for you to prepare a variety of business documents, including leases, contracts for the purchase of a business or real estate, and contracts for hiring employees and independent contractors.

Materials Written Primarily for Lawyers and Law Students

- *Contracts in a Nutshell*, by Claude D. Rohwer and Anthony M. Skrocki (West). This provides a good overview of contract law.

- *Sales and Leases of Goods in a Nutshell,* by Frederick H. Miller (West). Here you'll find a legal analysis of the Uniform Commercial Code sections dealing with sales.
- *Basic Legal Forms with Commentary,* by Clifford R. Ennico and Marvin Hyman (West). This one-volume work offering clear and comprehensive forms is found in many law offices. It's more expensive than the other books on the list, but well worth the price if you draft a lot of contracts.

Signing Your Contracts

Many contracts take the form of a single document containing a series of numbered clauses. Each party signs two copies, and each keeps a copy. But as discussed throughout this chapter, some written contracts are much less formal. Commonly they're in two—or more—parts. For example, A sends B an offer; B accepts by a separate letter or fax. Or A sends B an offer; B sends back a counteroffer; A accepts the counteroffer by letter or fax. As long as there's a genuine meeting of the minds, a contract contained in several documents is valid.

Another form of contract is a letter that pulls together the details of your deal and is accepted by the other person by a signature at the bottom. This is typical when you and the other party (perhaps someone you've worked with often) have worked out the deal over lunch or through a series of phone calls and don't feel the need for a formal contract. An example is shown below.

September 10, 20xx

Dear Mary:

I'd like to summarize our agreement for you to redecorate our store at 123 Main Street. We agreed that for $2,000 you'll apply wall covering to the south wall of our sales areas and apply two coats of paint to the remaining walls. The paint will be XYZ brand latex semigloss, and the wall covering will be ABC brand vinyl, pattern #66.

In addition to the $2,000 payment, I'll promptly reimburse you for the paint and wall covering at your cost (when you present invoices from RacaFrax Wall Coverings), but you'll be responsible for the cost of all other tools, equipment, and supplies.

I'll pay you $1,000 before you start work and the balance within seven business days after the work is completed. You'll do the work on the next two Sundays so that our business isn't interrupted. The quality of your work will meet or exceed the job you recently completed for the Ski Shoppe next door.

We also agreed that if any problems come up about this job and we can't resolve them ourselves, we'll submit our dispute to Metro Mediators, Inc. for mediation and, if that doesn't resolve the problem, to binding arbitration—and we'll split the cost 50-50.

If I've accurately stated our agreement, please sign the enclosed copy of this letter and return it to me by noon Wednesday.

Sincerely,

Jim Dalton
d/b/a Jim's Fitness Shop

The above terms are acceptable to me.

Date: _____ Mary Walz _____

Revising a Contract Before You Sign

In negotiating a contract, it's common for the parties to go back and forth through several drafts, refining the language. You can easily revise your agreement using your word processing program. If you take this approach, just print out a fresh copy before signing the agreement. For minor changes, you can cross out the old wording and write in the new, using a typewriter or pen. Each party should initial each change to establish that the changes were agreed upon.

Another way to handle changes is to put them in an addendum. If you use an addendum, state that in case of a conflict between the addendum and the main contract, the wording in the addendum prevails. Both parties should sign the addendum and the main contract.

If a contract has gone through several revisions, it's a good idea to have both parties initial each page so that you're sure everyone has a correct copy of the final draft.

Signatures

How a contract should be signed depends on the legal form of your business.

- **A Sole Proprietor** can simply sign his or her name, because a sole proprietorship isn't a separate legal entity. But there are two other ways to do it, either of which is just as legal.

Method 1:

Jim Dalton

D/B/A Jim's Fitness Shop

[*D/B/A means "doing business as."*]

Method 2:

Jim's Fitness Shop

By: _____

Jim Dalton

- **For a Partnership,** the following format is commonly used:

ARGUS ELECTRONICS,
A Michigan Partnership

By: _____

Randy Argus, a General Partner

Only one partner needs to sign on behalf of a partnership.

- **For a Limited Liability Company,** use this format:

REALTY APPRAISAL SERVICES, LLC

By: _____

Sheila Martin, Member [*or Manager*]

- **For a Corporation,** use this format:

KIDDIE KRAFTS, INC.,
A California Corporation

By: _____

Madeline Arshak, President

A person signing as a corporate officer doesn't assume personal liability for meeting contractual obligations. (See Chapter 1 for a discussion of how using the corporate form of doing business can limit the personal liability of people operating the corporation.) If the other party to a contract is a corporation, you may (particularly in a major transaction) want to see a board of directors' resolution or corporate bylaws authorizing the particular officer to sign contracts on the corporation's behalf. You can omit this step if the contract is signed by the corporate president; a president is presumed to have authority to sign contracts for a corporation.

If you're entering into a contract with a corporation and want someone (such as a corporate officer or major shareholder) to sign a personal guarantee, you can use a clause like this one at the end of the contract:

In consideration of Seller entering into the above contract with Starlight Corporation, I personally guarantee the performance of all of the above contractual obligations undertaken by Starlight Corporation.

_____

Liz Star

FORM

Chapter 1 of *Legal Forms for Starting & Running a Small Business*, by Fred S. Steingold (Nolo), contains additional information on signing business contracts.

Witnesses and Notaries

Notarization means that a notary public certifies in writing that:

- you're the person you claim to be, and
- you've acknowledged under oath that you have signed the document.

Very few contracts need to be notarized or signed by witnesses. The major exceptions to this rule are documents that are going to be recorded at a public office charged with keeping such records (usually called the county recorder or registrar of deeds). These documents are described in the next section. Occasionally—but very rarely—state laws require witnesses or notaries to sign other types of documents.

Recording

The great majority of business contracts don't have to be publicly recorded—and, in fact, are usually ineligible for recording. Here are the exceptions:

- Documents that affect title to or rights in real estate. This includes deeds, mortgages, trust deeds (a form of mortgage used in many states), and easement agreements.
- Long-term real estate leases, or memoranda summarizing them.
- Some documents dealing with tangible personal property, such as UCC financing statements or chattel mortgages, when the seller or a third party is financing part of the purchase price and receiving a security interest (contingent ownership) in the property. Banks, for example, routinely record security interests when making equipment loans.

Dates

When you sign a contract, offer, counteroffer, or acceptance, include the date—and make sure the other person does too. This helps to establish that there was agreement (remember, a meeting of the minds is an essential element of any valid contract). A simple way to do this is to always put a date line (Date: _____, 20xx) next to the place where each person will sign. Don't worry if the dates of signing differ by a few days or even a week, as is common when the parties exchange documents by mail.

EXAMPLE:

If you sign on Monday and the other party signs a week later, you have a valid contract unless (1) you revoked your signature before the other person signed, or (2) you stated in the contract or offer that the other person must accept the offer before that date.

Originals and Photocopies

A contract is an "original" as long as the signatures are originals. So a photocopied document that both parties then sign is an original. So is a carbon copy or computer-printed copy that both parties sign.

If you enter into a traditional written contract—one document that contains the full agreement of the parties and is signed by both of them—it's best

if each party has a copy of the contract with the original signatures of both parties. This is easy if you sign at the same session; simply sign two originals, so each party can keep a fully signed one.

A photocopy or faxed copy of a signed contract can still be enforced as long as the judge or arbitrator is convinced that what you have is an accurate reproduction of the original.

Storing Contracts

Store your contracts and other important documents in a fireproof safe or file cabinet. Another precaution is to keep photocopies of all important documents at another location. This may seem like overkill—but not if you have to prove what's in a contract and all copies have been destroyed, stolen, or lost.

Revising a Contract After Both Parties Sign

Once a contract has been signed, any changes must be agreed to by both parties. In essence this means they're forming a new contract. The simplest way to make fairly minor revisions to a signed contract is through an addendum—or a second or third addendum if necessary. When you write an addendum, follow these steps:

- Refer to the earlier contract by date, names of the parties, and subject matter.
- State all of the changes.
- State that in case of a conflict between the terms of the original contract and the addendum, the terms of the addendum prevail.
- Make it clear that all terms of the original contract, except those that you're changing, remain in effect.
- Sign and date the addendum and keep it with the original.

LAW IN THE REAL WORLD

Writing Contracts the Simple Way

Galen owns a small publishing company that specializes in local guide books. Henry, one of Galen's longtime authors, is late in delivering a manuscript for a book on 50 offbeat family adventures in the Northern Rocky Mountains. When he finally turns it in, the printed manuscript is full of nearly incomprehensible handwritten additions.

Galen calls Henry and points out that their contract requires Henry to submit the manuscript neatly typed. Henry is furious. "You told me to get it done fast, no matter what," he says. "I stayed up half the night for two weeks to make the deadline and this is the thanks I get."

Galen prudently waits a few days and then invites Henry to lunch. Once both men look at the plain language of the contract, "Author shall submit all manuscript material neatly typed," Henry has to agree that Galen is right. Galen then offers to have someone on his staff do the typing work and subtract the cost from Henry's future royalties. They scribble the contract addendum on a paper placemat and both sign it. Later, Galen photocopies the placemat and mails it to Henry.

Enforcing Contracts in Court

Often, if there's a dispute about a claimed breach of contract, you can resolve it through negotiation. If that doesn't work, you'll need to use one of the other methods of resolving legal disputes: mediation, arbitration, or litigation. (See Chapter 22 for an overview on how each works.)

Most people prefer to resolve their contract disputes by mediation because it's an effective, cost-efficient, and less adversarial process than litigation. If mediation doesn't work and you resort to a more

formal proceeding—arbitration or a lawsuit—you'll likely be focusing on two basic questions:

- Was there a breach of contract?
- If so, what relief should be awarded to the nonbreaching party?

We'll tackle the first question in this section, and the second one in "What Can You Sue For?" below.

Suppose your business sues or is sued for an alleged breach of contract or such a claim is taken to arbitration. What defenses can the defendant assert? Here are the main ones:

- **No valid contract was formed.** If there was no meeting of the minds (no legally binding offer and acceptance) in the first place, or no consideration was given in exchange for one party's promise, no contract even exists. (See "What Makes a Valid Contract," above.) It's a lot easier to establish such a claim if neither side has begun to follow and rely on the so-called contract.
- **There's no written contract, and because of the subject of the contract, one is required by law.** (See "Must a Contract Be in Writing?" above.)
- **The contract is void because it's illegal or against public policy.** Contracts that call for criminal or immoral conduct may be unenforceable. (See "Unfair or Illegal Contracts," above.)
- **The contract should be rescinded (canceled) because the other side misrepresented the facts, the contract was induced by duress, or there was a mutual mistake.** (See "Misrepresentation, Duress, or Mistake," above.)
- **There was no breach of contract.** The defendant admits entering into a valid contract with the plaintiff, but fully complied with its terms.
- **The other party suffered no damages.** The breach of the contract was minor or technical and didn't cause the plaintiff any actual loss or damage. For example, if your store delivered a conference table and six chairs to a lawyer's new office a week later than promised, there's likely been minor inconvenience but no real damage—nothing serious enough to make you liable for breach of contract.
- **The plaintiff failed to limit (mitigate) the damages.** All parties to a contract have a legal duty to act reasonably and keep any damages to a minimum (called "mitigation of damages" in legalese). Or, put another way, it's not legally permissible to sit back and let damages add up when reasonable steps could be taken to stop or limit them. For example, suppose your company services refrigerators, and you signed a two-year contract with a butcher. While you're on vacation, the butcher calls your company and requests that you immediately repair a breakdown in his refrigerator. Your chief assistant is sick, so the job doesn't get done until you return ten days later. The butcher sues for damages, claiming he lost $5,000 worth of meat due to lack of refrigeration. You can point out that the butcher could have mitigated his damages by calling another company to fix his refrigerator. Had he done this promptly, his loss might have been limited to $500 of particularly temperature-sensitive meat plus $300 for the extra service charged. You should be responsible for $800 in damages and not the full $5,000.

RELATED TOPIC

Chapter 13 explains how the concept of mitigation of damages applies where a lease is involved. This information is generally applicable to all contracts.

Enforcing Lost Contracts

What if a party wants to legally enforce a written contract, but neither party can find a signed copy? The contract is still legally enforceable if you can prove to the satisfaction of an arbitrator or judge that:

- a written agreement was actually signed, and
- it contained the specific terms you're seeking to enforce.

You may be able to reconstruct the terms from an unsigned photocopy or from a final draft stored on your computer.

What Can You Sue For?

In a breach-of-contract case, the court may award the plaintiff money damages and may also, in some cases, order the defendant to do—or stop doing—something.

Compensatory Damages

If a plaintiff proves that a defendant breached a contract, the usual approach is for the judge or arbitrator to award the plaintiff "compensatory damages." The goal is to put the parties in the same position as they would have been in if the contract had been performed—or to come as close to that as possible.

Let's return to the contract with Joe, the sign maker we discussed at the beginning of this chapter. If Joe failed to build the sign for your business, and it cost you $750 to have someone else do it, you'd be entitled to recover $300 from Joe for breach of contract. This is the difference between the contract price you and Joe agreed on ($450) and what you had to pay to get the job done ($750). This assumes that you made a reasonable effort to limit or mitigate your damages. In this situation, you'd have to show that you made a reasonable attempt to find a second sign maker to do the job at a fair price. You couldn't just go to the most expensive sign maker in the state and expect Joe to reimburse you for the top dollar.

Consequential Damages

A plaintiff may also be entitled to "consequential damages." These are damages that arise out of circumstances that the breaching party knew about or should have foreseen when the contract was made.

For example, what if Joe built your sign for you but didn't get around to installing it until a month after your business's grand opening? Can you sue for the profits you lost because potential customers didn't know your store was there? The usual rule is that you can recover for lost profits only if this issue is covered by your contract or if it was foreseeable to both parties when you signed the contract that you'd lose profits if the other person didn't carry out the contact. Whether or not a judge will award you damages for Joe's failure to install your sign on time is anybody's guess—unless you specifically dealt with the issue in the contract.

If the contract did provide for lost profits, there's another problem: The amount of lost profits you claim must be ascertainable with reasonable certainty. With a new store, you have no earnings history. This makes it difficult to prove and recover lost profits. But you may able to show how much similar stores at similar locations earned when they first started and get a judge to accept this as a reasonable estimate of your losses.

Let's look at one more example. Say that the sign you ordered from Joe was to contain your store name plus the name of a major manufacturer of merchandise you planned to carry. You had a deal with the manufacturer that entitled you to a 10% discount if you put the manufacturer's name on your sign. Because Joe put up the sign a month after the store opened, you didn't receive the discount on the first batch of merchandise, which

cost you an extra $1,000. Can you collect this money from Joe? Only if Joe knew about your deal with the manufacturer when you and he entered into your contract. Otherwise, Joe would have no reason to expect you to suffer this additional loss if he installed the sign late.

Liquidated Damages

In addition to or in place of compensatory and consequential damages, a plaintiff may be able to recover "liquidated damages." These are damages that the parties agree in the contract will be paid if there's a breach. That is, instead of trying to determine the money damages for a breach of contract after the fact, you do it in advance.

For example, because actual losses caused by late installation of your sign would be difficult to determine, you and Joe could agree in your contract that for each day of delay, Joe would owe you a $25 late fee. If the liquidated damages are a reasonable attempt to estimate the losses you'd suffer and are not intended as a penalty, a judge or arbitrator will enforce this clause.

Contracts for the purchase of real estate commonly contain a liquidated damages clause. For example, if you put down $5,000 in "earnest money" when you sign a contract to purchase a building, the contract will likely allow the seller to retain the $5,000 as liquidated damages if you later back out for no good reason.

Injunctions and Other Equitable Relief

In addition to monetary damages, a judge may order "equitable" relief in some circumstances. This can come in a variety of forms, depending on the facts of the case and the judge's ingenuity. The idea is to reach a fair result and do justice in a way that can't be done simply by a monetary award. Here are some equitable remedies that a judge may order:

- **Injunctions.** An injunction is an order a judge issues that prohibits a person from performing specified activities. Occasionally, a judge issues an injunction to prevent a party from violating a contract. When time is of the essence, a judge may issue an emergency injunction (sometimes called a temporary restraining order) without a hearing to freeze matters until a court hearing can be held.

EXAMPLE 1:

Aggie accepts a job as the accounts manager for DDS Innovations, a dental supply house. As part of her employment contract, she signs a covenant not to compete in the same business in a four-county area for two years after leaving the company. After 18 months on the job, Aggie quits and starts a business in the same city, competing directly with DDS Innovations. The company sues Aggie for breach of her covenant not to compete. The judge, after conducting a trial, finds that the covenant not to compete is reasonable and legally valid, and enjoins Aggie from continuing in that business for two years.

EXAMPLE 2:

Maurice and Albert are business partners who have a falling out. Unable to resolve the dispute, Maurice sues Albert, claiming a breach of the partnership agreement. Albert countersues. The judge holds a preliminary hearing and issues a preliminary injunction—in force while the lawsuit is pending—prohibiting both partners from removing any property from the offices of the partnership and from taking any money from the partnership bank account.

EXAMPLE 3:

Gilda and her landlord, Archie, have a dispute over who is to pay for electricity to Gilda's restaurant. On Friday afternoon, Archie threatens to shut off the power to Gilda's restaurant, which would ruin a private banquet for 200 guests that night. Based on Gilda's

affidavit (sworn statement) showing the likelihood of immediate damage, the judge issues a temporary restraining order (TRO) prohibiting Archie from shutting off Gilda's power. The judge schedules a hearing for 9 a.m. Monday, at which time the TRO may be dissolved or continued. Because a TRO is usually issued based on the statements of one party only ("ex parte" in legal lingo), such an order is signed only if there's an emergency. A court hearing is always scheduled promptly.

- **Specific Performance.** If a contract concerns a unique or special asset—such as a piece of real estate, a work of art, or a uniquely valuable item of jewelry—the judge may order the losing party to deliver the property to the other party to carry out the agreement. This remedy is rarely used in any other type of commercial transaction.
- **Rescission.** In an appropriate case a judge may rescind (cancel) a contract and order restitution (return) of any money already paid. This unusual remedy is generally reserved for situations where one party's breach has completely frustrated the objectives of the other party, and the judge decides that it would be unfair to enforce the contract. To obtain rescission, the party getting a refund must give up any benefits already received. (Grounds for rescission of a contract are discussed earlier in this chapter.)

If a judge orders you to perform a contract or stop doing something that violates a contract, you can find yourself in deep trouble if you don't obey the order. You can be held in contempt of court, which is punishable by fines and even time in jail.