

CONTRACTS LAW

The purpose of this building block chapter is to provide an overview of the basic principles of contracts law.

In later chapters, we discuss special types of contracts: Web development agreements are discussed in chapter 8, contracts with employees in chapter 5, contracts with independent contractors in chapter 6, licenses in chapter 10 and 21, and contracts for the distribution of Web products in chapter 13. The special legal rules that apply to contracts for the sale of goods are discussed in chapter 18.

What Is a Contract?

A contract is a legally enforceable agreement between two or more parties. The core of most contracts is a set of mutual promises called “consideration.” The promises made by the parties define the rights and obligations of the parties.

Contracts are enforceable in the courts. If one party meets its contractual obligations and the other party doesn’t (“breaches the contract”), the nonbreaching party is entitled to receive relief through the courts.

EXAMPLE

Web Developer promised to pay Graphic Designer \$5,000 for creating certain graphics for Developer’s Web site design project. Graphic Designer created the materials and delivered them to Developer, as required in the contract. Developer admits that the materials meet the contract specifications. If Developer does not pay Graphic

with you, insist that the contract be reviewed and signed by the corporation's president.

A corporation has a separate legal existence from its founders, officers, and employees. Generally, the individuals associated with a corporation are not themselves responsible for the corporation's debts or liabilities, including liability for breach of contract.

EXAMPLE

Lisa, a Web developer, entered into a Web development agreement with Start-Up Company. Lisa fulfilled her duties under the agreement, but Start-Up doesn't have the money to pay her. Start-Up's president has plenty of money, and Lisa would like to collect the money from him. She can't, unless the president personally guaranteed Start-Up's obligations.

Offer and Acceptance

A contract is formed when one party (the "offeror") makes an offer that is accepted by the other party (the "offeree"). An offer—a proposal to form a contract—can be as simple as the words, "I'll wash your car for you for \$5." An acceptance—the offeree's assent to the terms of the offer—can be as simple as, "You've got a deal." Sometimes acceptance can be shown by conduct rather than by words.

When an offer has been made, no contract is formed until the offeree accepts the offer. When you make an offer, never assume that the offeree will accept the offer. Contractual liability is based on consent.

EXAMPLE

John offered to pay Photographer \$500 to use Photographer's photo in John's e-commerce Web site. Photographer said, "Let me think about it." John, assuming that Photographer would accept the offer, used the photo. Photographer then rejected John's offer. Unless fair use applies, John has infringed Photographer's reproduction and public display rights by using the photograph. John should not have assumed that he would be granted a license (a form of contract) by Photographer.

WHEN IS AN ACCEPTANCE EFFECTIVE?

According to the “Mailbox Rule,” an acceptance that is mailed is effective when it is deposited in the mail. When is an emailed acceptance effective—when the sender pushes the “send” button, when the email message is available for the recipient to open, or when the recipient opens it? Good question, there is no answer yet.

When you are an offeree, do not assume that an offer will remain open indefinitely. In general, an offeror is free to revoke the offer at any time before acceptance by the offeree. Once the offeror terminates the offer, the offeree no longer has the legal power to accept the offer and form a contract.

EXAMPLE

Animator offered his services to Developer, who said, “I’ll get back to you.” Developer then contracted with Client to quickly produce a Web-based product involving animation (making the assumption that Animator was still available to do the animation work). Before Developer could tell Animator that he accepted Animator’s offer, Animator sent Developer an email that said, “Leaving for Mexico. I’ll call when I get back.” Developer and Animator did not have a contract. Developer should not have assumed, in entering into the contract with Client, that Animator was still available.

When you are the offeree, do not start contract performance before notifying the offeror of your acceptance. Prior to your acceptance, there is no contract. An offer can be accepted by starting performance if the offer itself invites such acceptance, but this type of offer is rare.

EXAMPLE

Big Company offered to pay Web Developer \$20,000 to create an e-commerce Web site for Big Company. Before Developer’s president notified Big that Developer accepted the offer, Big sent Developer an email that said, “We’ve changed our minds. Due to budget cuts at Big Company, we’re canceling the project.” In the meantime, Developer’s staff had begun preliminary work on the project. Developer and Big did not have a contract, so Developer has no legal recourse against Big for loss of the deal or for the costs of the preliminary work.

Until an offer is accepted, the offeror is free—unless it has promised to hold the offer open—to revoke the offer.

- Through online conduct, such as clicking on an “I accept the terms” button.
- Through Electronic Data Interchange (EDI), electronic exchange of purchase orders, and other standardized business documents between computers in a computer-processable format.

As we noted earlier in this chapter, in “Written Contracts,” certain contracts must be in writing to be valid. Over half the states have passed laws making electronic records the equal of “hard copy” written records (and a federal law is being considered by Congress). Unfortunately, these laws take three different approaches:

- **The “automatic equivalence” approach** (electronic records are the equivalent of hard copy records).
- **The “by agreement” approach** (electronic records are the equivalent to hard copy records if the parties to the transaction have so agreed).
- **The “digital signature” approach** (electronic records are the equivalent to hard copy records if they are signed with digital signatures using special encryption technology).

Consideration

Consideration, in legal terminology, is what one party to a contract will get from the other party in return for performing contract obligations.

EXAMPLE

Web Developer promised to pay Artist \$500 if Artist would let Developer use one of Artist’s drawings in Developer’s new project. The consideration for Developer’s promise to pay Artist \$500 is Artist’s promise to let Developer use the drawing. The consideration for Artist’s promise to let Developer use the drawing is Developer’s promise to pay Artist \$500.

According to traditional legal doctrine, if one party makes a promise and the other party offers nothing in exchange for that promise, the promise is unenforceable. Such a promise is known as a “gratuitous promise.” Gratuitous promises are said to be “unenforceable for lack of consideration.”

EXAMPLE

John told Sam, “When I buy a new car, I’ll give you my truck.” John bought a new car but did not give Sam the truck. According to traditional legal doctrine, John’s promise to give Sam the truck is an