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CONTRACT FORMATION ISSUES
WHEN CONTRACTING FOR GOODS,
SERVICES, AND PEOPLE

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I. INTRODUCTION

The basic premise of American contract law is that parties can agree to order their affairs as they see fit, with minimal intervention by courts and legislatures. This remains the model, particularly when dealing with oil and gas agreements where traditional give-and-take bargaining occurs among sophisticated parties. For example, in Nearburg v. Yates Petroleum Corp., the New Mexico Court of Appeals refused to grant Yates a second chance to elect to participate in drilling a well when it failed to respond within the 30-day time frame set by the operating agreement. In reversing the trial court’s “equitable” approach to the issue, the Court of Appeals

1 HENRY MAINE, ANCIENT LAW 170 (1861).

2 The Restatement (Second) of Contracts articulates the concept as follows:

The principle of freedom of contract is itself rooted in the notion that it is in the public interest to recognize that individuals have broad powers to order their own affairs by making legally enforceable promises.


4 The court enforced, as written, the Article VI(B) additional well drilling procedures of the A.A.P.L. Form 610-1977 Model Form Operating Agreement. Id. at 564.
stated: “A court should . . . not interfere with the bargain reached by the parties unless the court
concludes that the policy favoring freedom of contract ought to give way to one of the well-
deﬁned equitable exceptions, such as unconscionability, mistake, fraud, or illegality.”5

However, such “freedom” also means courts should not rescue a party from what turns
out to be a bad bargain. Freedom of contract creates both a “right” and an “obligation” to ensure
it is used properly to accomplish the intended goals. The purpose of this Special Institute on Oil
and Gas Agreements is to assist the transactional lawyer in using this freedom to accomplish
client goals while avoiding unanticipated or unintended consequences.

II. WHICH BODY OF CONTRACT LAW APPLIES?

When dealing with goods, services, and people contracts, the ﬁrst task is deciding which
body of contract law must be applied to evaluate the transaction. It is difﬁcult to arrive at the
correct legal analysis of the issues if you are not applying the correct body of law. At the ﬁrst
level of analysis, it must be determined whether the subject matter of the transaction involves a
sale of goods, a lease of goods, or non-goods.

A. First Level of Analysis: The General Legal Categories

In the oil and gas law context, transactions can be placed into three general “contract
law” categories. The ﬁrst two relate to transactions in tangible personal property: “goods.” These
include a “sale” of goods and a “lease” of goods, both governed by the Uniform Commercial
Code. The third category encompasses non-goods transactions, which include real property,
intangible personal property, and services. These are not governed by the Uniform Commercial
Code, but instead by what can be loosely characterized as “general contract law.”

It is critical to ensure the subject matter of a contract is properly categorized so the
appropriate body of law can be applied. There are many unique contract rules within the UCC
that are fundamentally different from general contract law. A recent decision by a West Virginia
federal district court provides an object lesson on the importance of properly categorizing
contracts. In Blueﬁeld Gas Company v. ABBS Valley Pipeline, LLC,6 the parties, in 1997, agreed
that ABBS would build a pipeline and supply gas to Blueﬁeld. ABBS would recover its pipeline
investment through a “reservation charge” Blueﬁeld would pay in addition to the price charged
for the delivered gas.7 The contract provided the reservation charge would be redetermined once
the pipeline capital costs were recovered. The recovery of costs that triggered redetermination

5 Id. at 571.


7 Id. at *1.
occurred in October 2002.\footnote{8} ABBS, however, continued to collect the full reservation charge. Bluefield sued ABBS for breach of contract on December 16, 2009.\footnote{9} ABBS defended asserting, in its motion for summary judgment, the statute of limitations barred Bluefield’s cause of action because it accrued as of October 2002.\footnote{10}

Whether ABBS would prevail on its statute of limitations defense turned upon proper categorization of its contract with Bluefield. If deemed a non-goods transaction, it would be governed by general contract law and West Virginia provides for a 10-year statute of limitations.\footnote{11} If deemed a sale of goods transaction, a 4-year statute of limitations would apply and bar Bluefield’s action because, as noted by the court: “this case began to accrue in October of 2002, and ran in October of 2006.”\footnote{12}

The contract, however, had non-goods service attributes related to the construction of a pipeline. The construction and operation of the pipeline were essential for ABBS to engage in the goods portion of the contract: the sale of natural gas as tangible personal property. The court resolved this initial classification issue applying the “predominant purpose” test.\footnote{13} Also known as the “predominant factor” test, it is used to categorize a contract as either a goods or a non-goods transaction when it involves a “hybrid” or “mixed” contract governing goods and non-goods.\footnote{14} Under the predominant purpose or factor test the court must find that the contract is either primarily a sale of goods, with incidental services provided, or primarily a non-goods transaction, with incidental goods supplied. Whatever is the primary purpose of the contract will dictate the body of contract law that must be applied to the contract.\footnote{15} In Bluefield the court held

\footnote{8} Id. at *6. \footnote{9} Id. at *3. \footnote{10} Id. at *4. \footnote{11} Id. \footnote{12} Id. at *9. \footnote{13} Id. at *5. \footnote{14} E. Allan Farnsworth, Contracts 383 (4th ed. 2004) (describing it as a “particularly vexing problem of classification”). \footnote{15} There is a competing theory, which the court in Bluefield labels the “gravamen-of-the-action test.” Bluefield, 2012 WL 40460 at *5. This approach requires that each component of the contract be classified as goods or non-goods, and then apply the appropriate body of goods or non-goods law to each. Public policy issues often impact application of the test. See Anthony Pools v. Sheehan, 455 A.2d 434 (Md. 1983) (diving board sold in conjunction with pool construction project was “goods” and therefore subject to Article 2 implied warranty protections).
"the primary purpose was to supply gas, not to build a pipeline."\textsuperscript{16} Therefore, the contract was governed by Article 2 of the Uniform Commercial Code and the 4-year statute of limitations applied.\textsuperscript{17}

1. Sale of Goods

UCC Article 2 deals with "transactions" in goods, defined to mean "sale" of goods.\textsuperscript{18} "Goods" are defined generally as "movable" tangible personal property.\textsuperscript{19}

\textsuperscript{16} \textit{Bluefield}, 2012 WL 40460 at *6.

\textsuperscript{17} \textit{Id.} at *9.

\textsuperscript{18} UCC § 2-102 provides:

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

The “contract to sell or present sale” transaction referenced in § 2-102 are further defined as follows:

In this Article unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (Section 2-401). A "present sale" means a sale which is accomplished by the making of the contract.

U.C.C. § 2-106(1).

\textsuperscript{19} UCC § 2-105(1) provides:

"Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (article 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (section 84-2-107).
2. Lease of Goods

Many oil and gas transactions concern a “lease” of goods, primarily equipment such as compressors. Article 2A of the Uniform Commercial Code governs the lease of “goods” with the same sort of unique provisions encountered in Article 2 regarding a “sale” of goods. For example, UCC § 2A-506(1) states: “An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within 4 years after the cause of action accrued.” Similarly, like its sales counterpart, this same section provides: “By the original lease contract the parties may reduce the period of limitation to not less than one year.”

3. Non-Goods

Non-goods is a term used to encompass any contract not covered by Articles 2 and 2A.

a. Services

Services include a number of oil and gas activities. For example, transporting oil and gas from the wellhead to a downstream destination is a service that would be governed by general contract law. Drilling, completing, logging, fracing, and other well “services,” are all governed by general contract law. However, it is possible to lease a drilling rig, or other equipment, along with the equipment operators. In that case, Article 2A would likely govern the transaction. For example, in Belger Cartage Service, Inc. v. Holland Construction Company, a crane and two employees that operated the crane were provided to Holland. While operating the crane the cable snapped damaging the Belger crane and Holland’s property the crane was lifting. The cause of the accident was attributed to Belger and its employees. The trial court held that only the crane had been leased to Holland, not Belger’s employees. The facts could have also supported a finding that Belger had been hired to provide a service as opposed to creating a lease relationship.

Sometimes an equally searching analysis is required to determine whether a transaction is a sale or a service. For example, a processing agreement can be structured as a sale of the gas, with the purchase price being paid in the form of liquid hydrocarbons and residue gas. Or, the

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20 U.C.C. § 2A-506(1). The parallel Article 2 language is found at UCC § 2-725(1).


22 Id. at 1114.

23 Although Belger’s work order clearly structured the transaction as a lease of the crane, and the two employees, the work order was not enforced because the critical terms were not encompassed by the parties’ mutual assent. Id. at 1115-16. See infra text accompanying notes 133-36 (discussing the mutual assent issues).
transaction may be structured as a service, with the processor retaining a share of the hydrocarbons as a processing fee. 24

b. Real Property

Uniform Commercial Code § 2-107 distinguishes the close calls between real property and goods by providing:

(1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

Easements, profits, nonparticipating royalties, and similar rights in real property will be governed by general contract law, even though they may be classified in some instances as personal property. Regardless of their classification, they are all interests in land and encompassed by either a classification as real property or as an intangible right, such as a contractual right.

c. Intangible Personal Property

Intangible personal property encompasses rights that may, or may not, be represented by a writing. Although the writing is tangible, its classification depends upon what the writing represents. A book is tangible personal property. But, the author’s copyright in the work, and his or her rights to royalty from the publisher, are intangible personal property.

B. Second Level of Analysis: Specialized Laws

Once the contract is placed in its proper general category, it must be further analyzed to determine whether there are specialized bodies of law that must be considered.

1. “Consumer” Transactions

If a "consumer" is involved in the transaction, it can trigger another body of law generally designed to protect the consumer’s interests. Often these statutes invalidate certain provisions that would be acceptable in a non-consumer transaction. They may also require that terms be presented in a special manner to be effective. Provisions for attorney fees, damages, and penalties are often available for violating consumer laws. Another problem is defining the basic scope of consumer laws; the term “consumer” is often defined broadly to include small business entities.

2. “Construction” Contracts

In many states there are special statutes limiting the use of certain risk-leveraging clauses, such as an indemnity clause, when contained in a “construction” contract. These are generic anti-indemnity statutes that must be considered in addition to those that exist in a few jurisdictions governing oil and gas contracts. For example, in Kansas the statute is Kan. Stat. Ann. § 16-121 and consists of a broad definition of “construction contract” followed by a list of exemptions from the definition. The primary effect of the statute is revealed by the following provision:


26 The Kansas Consumer Protection Act defines “consumer” to include a “family partnership” and includes the acquisition of property or services for “business” purposes. KAN. STAT. ANN. §50-624(b).

27 KAN. STAT. ANN. § 16-121(a) provides:

(1) "Construction contract" means an agreement for the design, construction, alteration, renovation, repair or maintenance of a building, structure, highway, road, bridge, water line, sewer line, oil line, gas line, appurtenance or other improvement to real property, including any moving, demolition or excavation, except that no deed, lease, easement, license or other instrument granting an interest in or the right to possess property shall be deemed to be a construction contract even if the instrument includes the right to design, construct, alter, renovate, repair or maintain improvements on such real property. "Construction contract" shall not include any design, construction, alteration, renovation, repair or maintenance of:

(A) Dirt or gravel roads used to access oil and gas wells and associated facilities; or
"An indemnification provision in a contract which requires the promisor to indemnify the promisee for the promisee's negligence or intentional acts or omissions is against public policy and is void and unenforceable."\(^8\)

3. Other Specialized Subject Matter Statutes

As the subject matter of a contract or clause becomes more precisely defined, additional research is required to ensure identification of all relevant statutes that might impact the parties' freedom to contract. This often requires researching special types of contracts, such as "construction" contracts noted above, and researching special types of clauses that the parties desire to use, such as an indemnity or other exculpatory risk-shifting provisions.

4. Field Code States

If you are dealing with a contract governed by the laws of California, Idaho, Montana, North Dakota, Oklahoma, or South Dakota, you must be aware that these states adopted at least portions of the "Field Code." The Field Code was the product of the great codifier David Dudley Field, and appealed to states that wanted what appeared to be an instant body of law superior to the piecemeal development of the common law. Montana, for example, has a number of statutes on contract law, and other basic topics, that depart from the general common law. If you practice in one of these states, you should read the scholarship of Professor Scott Burnham addressing the Field Code.\(^29\) Many times these statutes are the classic "rabbit-out-of-the-hat" litigation event where you find statutory language addressing a matter that has been ignored for over 100 years. Often a body of case law has developed contrary to a statute because it has never been found and brought to the court's attention.

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(B) oil flow lines or gas gathering lines used in association with the transportation of production from oil and gas wells from the wellhead to oil storage facilities or gas transmission lines.

(2) "Contract" means any construction contract, motor carrier transportation contract, dealer agreement or franchise agreement.

\(^{28}\) KAN. STAT. ANN. § 16-121(b).

III. CONTRACT FORMATION ISSUES

It is easy to create a contract.\(^{30}\) The absence of formalities means an enforceable agreement may arise before a party consciously realizes their actions have given rise to a contractual relationship. This is made possible by the American objective theory of contracts: what would a reasonable person be led to believe by the other party’s actions? Although the person making the statements or sending the letter may have subjectively intended not to make an “offer,” or exercise a “power of acceptance,” if that person’s objective (outward) manifestations indicate otherwise, such objective manifestations will control over the person’s true subjective intent.\(^{31}\) As with most rules of contract law, this creates a “burden” and an

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\(^{30}\) The basic requirements include: (1) Parties with the capacity to contract; (2) mutual assent; and (3) consideration. To be enforceable the resulting contract must be: (1) Definite enough to enforce; (2) comply with the statute of frauds; and (3) not violate public policy.

\(^{31}\) Exceptions to the objective theory include when both parties in fact have the same subjective intent (they both mean “X” even though to the outside world it would appear to mean “Y”), or one party is aware of the other party’s subjective intent. Section 20 of the Restatement (Second) of Contracts catalogs these situations under the heading “misunderstanding” and provides:

1. There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and
   a. neither party knows or has reason to know the meaning attached by the other;
   or
   b. each party knows or each party has reason to know the meaning attached by the other.

2. The manifestations of the parties are operative in accordance with the meaning attached to them by one of the parties if
   a. that party does not know of any different meaning attached by the other, and
      the other knows the meaning attached by the first party; or
   b. that party has no reason to know of any different meaning attached by the other, and the other has reason to know the meaning attached by the first party.

**Restatement (Second) of Contracts § 20 (1981).** The most common example of the varying subjective intent resulting in a lack of mutual assent is *Raffles v. Wichelhaus*, 2 Hurl & C 906 (Cl. of Exchequer 1864) (agreement to purchase cotton to arrive in Liverpool from Bombay aboard the ship “Peerless” and the evidence showed one party intended the Peerless sailing from Bombay in October, while the other intended a different Peerless sailing from Bombay in December). An example of this principle being used in an oil and gas context is *Sidwell Oil & Gas Co., Inc. v. Forbes*, 630 P.2d 1107 (Kan. 1981), where the court found the landman intended
“opportunity.” The burden occurs when a person fails to account for the rule and gives off objective messages not in accord with their subjective intentions. The opportunity is the ability to control the situation to ensure the person’s “objective” message is consistent with their “subjective” intentions. This is what lawyers do, or should do, for their clients.

Controlling the formation of a contract involves making the parties’ contractual status clear at all stages of a transaction leading up to the consummation of mutual assent. The critical task is distinguishing when the parties are engaging in “preliminary negotiations” leading up to the creation of a “power of acceptance,” the “offer,” or the exercise of a “power of acceptance,” the “acceptance.” The lawyer’s role, and drafting task, is ensuring every party, at every stage of the contract formation process, can at any time answer the following two questions:

(1) Has a power of acceptance been created (is there an offer)?

(2) Has a power of acceptance been exercised (is there an acceptance)?

Until there is a power of acceptance that has been exercised, the parties are engaged in preliminary negotiations, which means, in most situations, they have no contractual restraints on their freedom of action. They can walk away without liability, or continue to negotiate in hopes of creating, and exercising, a power of acceptance.

The analysis is simply determining whether the activity constitutes preliminary negotiations or rises to the level of an event, either offer or acceptance, which has the potential to limit a party’s freedom of action. Each party has it within their power to minimize doubt about their status as preliminary negotiator, offeror, or acceptor.

LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW 541 (7th ed. 2001).
A. Effectively Controlling the Creation of a Power of Acceptance

1. Offer or Preliminary Negotiations?

The challenge is to distinguish manifestations that constitute an “offer” from mere preliminary negotiations. The Restatement (Second) of Contracts defines an “offer” as:

[T]he manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it. 34

“Preliminary negotiations” are defined as:

A manifestation of willingness to enter into a bargain is not an offer if the person to whom it is addressed knows or has reason to know that the person making it does not intend to conclude a bargain until he has made a further manifestation of assent. 35

The lawyer’s role, when they are involved at this stage of the transaction, is to ensure everyone involved “knows or has reason to know” of their contractual status.

The easiest way to do this is to employ the sort of language courts will look for while ensuring it objectively conveys the message that is consistent with the client’s subjective intent. For example, if the client wants to ensure it is creating no power of acceptance in the other party, consider using the following language to objectively express the client’s subjective intent:

PRELIMINARY NEGOTIATIONS ONLY. This correspondence does not create any sort of offer or power of acceptance. Instead, the statements made in this letter merely constitute preliminary negotiations.

2. The Letter of Intent

The letter of intent is often used to memorialize negotiations. The “intent” of the letter is typically to enter into a contract—if the parties can come to an agreement on all the essential terms. The letter of intent states what the parties have tentatively agreed upon, and what remains to be done. However, when it appears the next formal step may not be forthcoming, the party

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36 I often tell my contracts students to consider the impact of the contract language when it is isolated, placed in a PowerPoint presentation, and projected on the wall for all to see and absorb.
desiring to complete the deal may argue the letter of intent gave rise to contractual obligations. The fundamental issue is the “intent” of the parties when entering into their letter of intent. The goal for the drafting attorney is to make the intent clear: Is a present contract intended, with some mere formality to be agreed upon? Or, do the parties intend they will not be bound until, and unless they are able to agree upon some additional form of agreement?

Even when the parties try to express their intent, sometimes it becomes equivocal. For example, in *ACT I, LLC v. Davis*,37 the parties entered into a “letter of intent” regarding the exploration and development of coalbed methane leases. Davis owned coalbed methane leases and ACT wanted to earn the right to acquire 35% of the Davis working interest in return for arranging financing to develop the leases. After setting out the basic description of the deal, the letter of intent stated:

[T]he parties understand and agree that the transactions contemplated by this letter are non-binding and subject to the following:

(a) Completion of definitive agreements incorporating terms of this letter on or before April 20, 2000 which deadline shall automatically extend for successive 10 day increments until any party gives notice of its intent to terminate this Letter of Intent delivered to all parties at least two (2) business days prior to such termination.38

The parties entered into an extension agreement on May 4, 2000 which gave ACT until May 20 “to obtain financing arrangements for the Project . . . .”39 The extension also stated:

“The parties agree to continue to work together on a best efforts basis to arrange for the completion of the financing upon receipt of an acceptable financing commitment.”

. . . .

“Upon receipt of an acceptable financing commitment, . . . [Davis and ACT] shall enter into definitive agreements to reflect the terms outlined in the Letter of Intent.”40

ACT obtained a financing commitment from a lending institution but Davis “decided they did not want to complete the deal and consequently never signed any loan documents.”41 Davis

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37 60 P.3d 145 (Wyo. 2002).
38 *Id.* at 147.
39 *Id.* at 147-48.
40 *Id.* at 148.
contended it was not bound to anything until it signed the financing agreement. Although the
trial court held the agreement was unenforceable under the statute of frauds, the Wyoming
Supreme Court reversed, finding that ACT was seeking to enforce the letter of intent, that had
been signed by both parties, as opposed to the financing agreement, which David had not
signed. 42

The court concluded the letter of intent was ambiguous and remanded to the trial court
for further proceedings. As the court noted:

Appellees [Davis] contend that they owe no duty to fulfill any of their obligations
under the LOI unless and until they formally execute a finalized, written financing
agreement. Appellant [ACT] argues that Appellees owed duties under the LOI as
soon as they orally expressed agreement to the terms of the proposed financing
commitment. At a minimum, Appellant argues, Appellees owed a duty to use their
“best efforts” to complete the financing agreement. 43

The ambiguity the court alluded to apparently related to when an “acceptable financing
commitment” had been achieved, and the ability of either party to terminate on a two-day notice
between the time the financing commitment was obtained and “definitive agreements
incorporating the terms of the Letter of Intent” were finalized. The “best efforts” obligation also
ran counter to an ability to refuse to work towards an agreement once a financing package was
offered.

It would seem as though many of these open issues, “omitted terms,” could be filled with
an implied obligation of good faith in the performance of the contract. 44 For example, “an
acceptable financing commitment” is required to trigger the “best efforts” obligation to work

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41 Id.

42 Id. at 150.

43 Id. at 150-51.

44 The Restatement, like the Uniform Commercial Code, provides:

Every contract imposes upon each party a duty of good faith and fair dealing in its
performance and its enforcement.

RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); U.C.C. § 1-203 (1977) (“Every contract
or duty within this Act imposes an obligation of good faith in its performance or enforcement.”).
The international counterpart can be found at UNIDROIT, Art. 1.7(1) (“Each party must act in
accordance with good faith and fair dealing in international trade.”). International Inst. for the
1.7 (1994) [hereinafter UNIDROIT].
toward the completion of financing. What is "acceptable" must be evaluated in light of the context, purpose, and spirit of the parties' deal, as articulated by the letter of intent. This means Davis, in exercising its discretion to determine whether the financing commitment is "acceptable," must exercise its discretion in good faith. The Restatement offers the following guidance on the meaning of "good faith:"

Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . .

Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct is justified. . . . A complete catalogue of types of bad faith is impossible, but the following types are among those that have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.

This analysis may eliminate the need to harmonize the other provisions, if the trial court finds, as a matter of fact, Davis did not act in good faith when evaluating whether the financing commitment was "acceptable." The fact the court has to make an inquiry at all demonstrates the inherent risks associated with a letter of intent: it may not give rise to a binding agreement on the object of the transaction, but it may impose intermediate obligations to try and work toward the object, such as a "good faith" evaluation of a financing commitment followed by "best efforts" to complete the financing. Sometimes the parties may be even less specific, but nevertheless contract to "negotiate" in good faith in an effort to arrive at a binding agreement.

3. Intermediate "Contract" to "Negotiate"?

At this stage of the process, it is also prudent to consider the body of case law where courts have found either a contractual obligation to negotiate, or have imposed liability on a reliance theory. In most instances both parties want to be free of any obligation at the

45 Restatement (Second) of Contracts § 205 cmt. a (1981).

46 Restatement (Second) of Contracts § 205 cmt. d (1981).

47 E.g., Channel Home Centers v. Grossman, 795 F.2d 291, 300 (3d Cir. 1986) ("the letter of intent and the circumstances surrounding its adoption both support a finding that the parties intended to be bound by an agreement to negotiate in good faith.").

48 E.g., Neiss v. Ehlers, 899 P.2d 700, 707 (Or. 1995) ("promissory estoppel can apply, under appropriate circumstances, to promises that are indefinite or incomplete, including agreements to agree.").
preliminary negotiation phase of a transaction.\textsuperscript{49} The problem arises with cases such as \textit{A/S Apothekernes Laboratorium for Specialpraeparater v. I.M.C. Chemical Group, Inc.},\textsuperscript{50} where the court holds the "letter of intent" signed by the parties did not create a contract for the purchase and sale of assets. However, the letter of intent did give rise to an enforceable contract requiring the parties to negotiate towards arriving at a contract for the purchase and sale of assets. Commenting on the concept of a contract to negotiate, the court states:

The obligation to negotiate in good faith has been generally described as preventing one party from, "Renouncing the deal, abandoning the negotiations, or insisting on conditions that do not conform to the preliminary agreement.". \textellipsis For instance, a party might breach its obligation to bargain in good faith by unreasonably insisting on a condition outside the scope of the parties' preliminary agreement, especially where such instance is a thinly disguised pretext for scotching the deal because of an unfavorable change in market conditions. \textellipsis The full extent of a party's duty to negotiate in good faith can only be determined, however, from the terms of the letter of intent itself.\textsuperscript{51}

The duty to negotiate is better developed under international contract principles. For example, the UNIDROIT Principles of International Commercial Contracts ("UNIDROIT"), provide:

\textbf{ARTICLE 2.15}

\textit{(Negotiations in bad faith)}

(1) A party is free to negotiate and is not liable for failure to reach an agreement.

(2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.

\textsuperscript{49} This is not to say that often one party will, at some stage of the transaction, find it advantageous to assert that some sort of duty to negotiate exists, or that they have detrimentally relied on the other party's willingness to try and negotiate the transaction to completion. These are typically after-the-fact revelations which neither party would have argued for going into the transaction because they could not evaluate, at that time, whether they would want to be on the "giving" or "receiving" end of the limitation. Of course, if you know what side of the argument you want to be on going into the transaction, this should be clearly articulated when negotiations begin.

\textsuperscript{50} 873 F.2d 155 (7\textsuperscript{th} Cir. 1989).

\textsuperscript{51} \textit{Id.} at 158.
(3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.\footnote{UNIDROIT, \textit{supra} note 21, at Art. 2.15.}

Similar language is found in the Principles of European Contract Law.\footnote{COMMISSION ON EUROPEAN CONTRACT LAW, \textit{Principles of European Contract Law}, Art. 2.301 (1999).}

Although it may not be so clear under international contract principles, under American contract law the parties can avoid any sort of obligation to negotiate by manifesting their intent accordingly. For example, the parties could add the following language to their “preliminary negotiations” section:

\begin{quote}
PRELIMINARY NEGOTIATIONS ONLY. This correspondence does not create any sort of offer or power of acceptance. \textit{Either party can terminate negotiations at any time, for any reason, or no reason, without any obligation to the other party.}
\end{quote}

4. Liability for Reliance?

The final lingering risk of pre-contractual liability is that the other party will claim they relied to their detriment on a preliminary understanding or on the fact the parties are engaged in negotiations. Such a claim will be designed to trigger \textit{Restatement (Second) of Contracts} § 90 which provides, in part:

\begin{quote}
A \textit{promise} which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.\footnote{\textit{Restatement (Second) of Contracts} § 90(1) (1981) (emphasis added).}
\end{quote}

Liability can arise from a mere “promise” as opposed to a “contract.” To avoid this risk, the drafting goal is to make it clear it would \textit{not} be reasonable for the other party to act in reliance on negotiations. For example, the parties could add the following language to their “preliminary negotiations” section:

\begin{quote}
PRELIMINARY NEGOTIATIONS ONLY. This correspondence does not create any sort of offer or power of acceptance. Instead, the statements made in this letter merely constitute preliminary negotiations. Either party can terminate negotiations
\end{quote}
at any time, for any reason, or no reason, without any obligation to the other party. Any expenditure of money, time, personnel, or other loss of value, associated with conducting negotiations, will be the sole responsibility of the party suffering the expenditure or loss. Under no circumstances will it be reasonable for either party to take any action in reliance on anything said, not said, represented, or otherwise revealed or discussed during these negotiations.

This is an area of frequent dispute. After investing time, money, and effort into negotiating a contract, the party that loses the final round of negotiation often seeks to turn it into a victory by proclaiming they have a contract. For example, in *Stanwood Boom Works, LLC v. BP Exploration & Production, Inc.*, a supplier of oil containment equipment was trying to make a sale to BP. Following several weeks of negotiations, BP elected not to accept Stanwood’s tendered purchase order. Stanwood sued, asserting they had already formed a contract. But, if no contract had been formed, Stanwood asserted it had detrimentally relied on BP’s actions, which led it to believe they had a contract. The court examined the sequence of events and concluded no contract was created and BP did nothing to justify Stanwood’s reliance. Key to the court’s finding was that throughout the process the BP negotiator made it clear no contract could be created until it was reviewed and approved by BP management. The court concluded, holding: “There was no contract. There were only negotiations and proposals.”

5. The Farmout “Offer” and “Preliminary Negotiations”

The situation addressed by the court in *Smith v. Sabine Royalty Corp.* illustrates the problems that can be caused, and averted, by routine correspondence regarding one of the most common exploration transactions: the farmout. Sabine owned a 1/6th mineral interest in Section 9. El Paso held a lease on the other 5/6ths and entered into a farmout agreement with Buckthal and Franklin, obligating them to begin drilling a well on Section 9 on or before December 1, 1974. In October 1974 Buckthal and Franklin assigned their rights in the farmout to Smith. Smith then asked Sabine to “join him in his drilling venture or lease or farmout its interest to him.” Sabine ultimately responded with the following letter dated November 7, 1974:

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56 Id. at *3.

57 Id. at *4. Approval would be indicated by obtaining the appropriate signature of BP management on the purchase order.

58 Id. at *4.


60 Section 9, Block M-2, H & GN Ry. Co. Survey, Roberts County, Texas. Id. at 366.

61 Id. at 367.
In confirmation of our recent telephone discussion and with particular reference to your letter dated October 28, 1974, as I informed you the management of this Company does not consider the drilling of your proposed test in the captioned section to be in the best interests of Sabine at this time. We strongly prefer that Section 10 be developed before drilling Section 9.

If you elect to proceed with the drilling of the Mirror test in Section 9, we would be willing to grant an oil and gas lease to our subsidiary, Dalco Oil Company, with the lease to provide for 1/4 royalty. Dalco would farmout this leased interest to you subject to the drilling of the proposed test with the understanding that production would be required to earn the interest and Dalco would retain a 50% backin option at payout of the well. By the drilling of your initial test and completing a producer, you would be entitled to 100% of this lease insofar as it covers the acreage allocation to the well, or proration unit and you would further be granted a 50% interest in the lease on any acreage outside the initial proration unit. Assuming you complete a gas well and the usual 640 acres plus 10% tolerance is established as field rules in this area you would, in that case, earn all of this leasehold interest in this section through payout. The farmout would be further limited to rights 100' below total depth drilled.

If you wish to pursue this arrangement, please let us know and the appropriate instruments will be forwarded for your approval.

Following this letter the parties did not communicate until January 9, 1975 when Smith telephoned Sabine's representative seeking to "reconfirm" the deal proposed in the November 7 letter. Sabine's representative indicated "management has considered the matter terminated." Smith sent a letter the same day to Sabine indicating he wanted to "accept the proposal" contained in Sabine's November 7 letter. Sabine again responding indicting that "management had already considered negotiations on the matter terminated." As of January 9, 1975, when Smith contacted Sabine, Smith had drilled a producing oil and gas well on § 9 and was aware of its productive capacity.

Smith argued that Sabine's November 7 letter, and Smith's January 9 letter, created a contract. The jury agreed, but the trial court granted Sabine's motion for judgment notwithstanding the verdict. On appeal, the issues focused on the legal effect of Sabine's

62 Sabine owned the 1/6th mineral interest in fee so there were no lessor rights to weigh.

63 Smith, 556 S.W.2d at 367.

64 Id.

65 Id. at 367-68.
November 7 letter: was it an offer, or merely preliminary negotiations? Although the court held the letter constituted preliminary negotiations and not an offer, the mere existence of the case, and a jury verdict finding otherwise, demonstrate the need for policing these issues whenever communicating with potential farmees, or more accurately, potential "plaintiffs."

Whenever faced with language that does not rise to the level of mutual assent, or that does not satisfy the statute of frauds, or when the existence of consideration is at issue, the complaining party will frequently employ a reliance argument. The argument focuses on "the promise," and the party's reasonable reliance on the promise, to avoid contract defenses. The complaining party is not seeking to enforce a "contract" but rather is seeking equitable relief, in the nature of estoppel, to prevent the other party from denying liability for their actions. This too is illustrated by the Smith case. As the court observed:

Smith . . . testified that he relied on the November 7 letter when he commenced drilling. According to Smith, drilling on the strength of such letters was customary in the business.

The court found that under the facts such reliance, if any, was not reasonable in light of the terms of the November 7 letter. The court seemed to assume that if the letter was indeed an offer, as

66 Justifying its conclusion, the court stated:

In our opinion, however, the November 7 letter was not an offer which could have been accepted by Smith's commencement of drilling. The terms of the letter indicated that Sabine and Dalco (Sabine's wholly owned subsidiary) would be willing to do if Smith elected to drill the well. The language used did not indicate that any offer was being extended at that time. Quite significantly, the terms of the letter invited a response from Smith if he wished to pursue the arrangement. In turn, Sabine would forward the appropriate instruments for Smith's approval. Nothing in the letter indicated any intent to extend an offer which could be accepted by drilling a well. It is our opinion that the letter was only an invitation to further negotiations.

Id. at 368.

67 The court noted:

The letter called upon Smith to respond to the proposal outlined; it did not authorize acceptance by performance. The letter, in our opinion, contemplated the making of a bilateral contract which would involve the preparation and approval of formal contract documents.

Id. at 369.

68 Id.
opposed to preliminary negotiations, the only authorized mode of acceptance invited by the offer was by Smith responding to Sabine’s “offer,” not the act of drilling a well.

Other courts have readily embraced a reliance theory when supported by the facts. For example, in *Strata Prod. Co. v. Mercury Exploration Co.*, the New Mexico Supreme Court employed a reliance theory to make binding a 120-day option period, and a 30-day extension, to drill under a farmout agreement structured as a unilateral contract. Mercury granted Strata the right to earn interests in Mercury’s oil and gas leases if Strata drilled a test well, within 120 days, on the farmout acreage known as the “Lechuza tract,” which was part of Strata’s “Red Tank Prospect.” Mercury represented to Strata that it controlled 100% of the working interest in the Lechuza tract that would entitle Strata to a 76.5% net revenue interest in the tract. Strata obtained the farmout from Mercury on August 28, 1991, assigned 98.5% of its rights under the farmout to 24 investors on October 1, 1991, and began drilling on land adjacent to the Lechuza tract on October 29, 1991. On November 10, 1991, Strata’s title attorney informed it that Mercury did not own 100% of the leasehold interest nor the represented percentage of net revenue interest. Strata attempted to obtain the missing interests and then, to earn under the Mercury farmout, commenced drilling on the Lechuza tract on January 10, 1992, completing a producing well in February 1992. Following a trial to the court, the value of this shortfall was set at $616,555.22, which were the damages awarded Strata against Mercury.

Mercury’s defense was that since this was a unilateral contract, and Strata had to drill to earn, Mercury retained the right to revoke its offer anytime prior to Strata’s commencement of drilling on the Lechuza tract. Although Mercury had granted Strata a 120-day option period in which to drill the well, plus a 30-day extension, Mercury noted it had received no consideration from Strata to support this option period. Therefore, Mercury could withdraw its offer anytime before Strata began performance, which in this case was after it learned, in November 1991, of the title problem. Strata, however, was successful in asserting that once it drilled, on October 29, 1991, on the adjacent lands comprising the Red Tank Prospect, it had acted in reliance on the belief it had all the acreage within the Prospect, including the Lechuza tract, under control. Strata’s reasonable reliance on Mercury’s representations were sufficient to impose liability on Mercury, even though the option “agreement” never matured into an option “contract” because it was not supported by consideration. The court observed:

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69 916 P.2d 822 (N.M. 1996).
70 *Id.* at 825-26.
71 *Id.* at 826.
72 *Id.* at 826-27.
73 *Id.* at 827.
74 *Id.* at 828-29.

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To invoke the doctrine of promissory estoppel, it is sufficient that the promisee substantially change its position, that this action was foreseen or foreseeable, and that a promise was made which induced the action or forbearance. 75

The drafter's goal is to avoid, at the pre-contract stage, making any promise which could justify the promisee in changing their position in reliance on the promise. This will be accomplished by including express language in the negotiations that make it unreasonable for the promisee to assert they could rely on promises or other statements comprising the negotiations.

B. Preparation of a More Formal Agreement

It is common for parties to negotiate a deal and then provide for it to be "formalized" in a written document to be signed by the parties. When a party seeks to walk away from a deal, or seeks new or different terms in trying to agree upon a formal written document, a dispute can arise over whether the parties intended to conclude a contract before, or only upon, agreeing to the written document. 76 Stated another way: was preparation of the subsequent writing an obligation under an existing contract or was it intended to be the consummate act of mutual assent when prepared and signed by the parties? The Restatement poses the issue as follows:

Manifestations of assent that are in themselves sufficient to conclude a contract will not be prevented from so operating by the fact that the parties also manifest an intention to prepare and adopt a written memorial thereof; but the circumstances may show that the agreements are preliminary negotiations. 77

As with most highly factual inquiries, this one is also readily manageable by the parties—by providing the facts the parties, and judges and juries, will need to answer the basic question: contract or preliminary negotiations? Consider the following approaches to the issue:

Present Agreement Intended

Upon acceptance of this offer, the parties intend to create a presently binding contract which includes the obligation to have this contract memorialized in a

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75 Id. at 829.

76 See, e.g., ASJ Interests v. Chesapeake Louisiana LP, No. 11-cv-1343, 2012 WL 2357313, at *6 (W.D. La. June 20, 2012) (holding that parties to leasing transaction contemplated a binding agreement would arise only when the agreement was finalized and the parties met to exchange documents and money).

formal written document acceptable in form to both parties and their legal counsel.\(^7^8\)

No Present Agreement Intended

The agreements contained in this letter are merely the parties’ preliminary negotiations and no obligations will arise between them until, and unless, they give their mutual assent by signing a formal written farmout agreement to be prepared by the proposed farmor.

The “formal agreement contemplated” problem is an example of a mixed issue of: (1) offer vs. preliminary negotiations; and (2) what must be done to exercise the power of acceptance. The two concepts are closely related but should be addressed separately in any document. This second element of the analysis, “exercising the power of acceptance,” is discussed in the next subsection.

C. Effectively Controlling the Exercise of a Power of Acceptance

If the intent is to create a power of acceptance in the other party, the offeror will want to be able to determine, at any time, whether the offer is still in effect and the exact moment it is accepted. This is simple to manage. If you don’t, then fairly artificial rules will be applied by courts to resolve the issue.

1. Managing the Offer: Lapse, Revocation, Acceptance

a. Lapse

Uncertainty as to a client’s contractual status should be avoided whenever possible. For example, absent a specific time stated in the offer, it will lapse after a “reasonable time.”\(^7^9\)

\(^7^8\) Aside for the mutual assent issues this language addresses, it should be readily apparent that anytime you seek to agree on something not presently in existence, there is a potential for conflict. These conflicts will be worked out applying a good faith standard to determine whether something is “acceptable in form” in light of the existing contract terms as supplemented by any prior course of dealing and industry custom and usage. The only way to avoid these sticky factual issues is to not agree to be bound until all the details are worked out and reflected in the formal written document. However, the “deal” often proceeds faster that its documentation and the parties may be more concerned with locking-in each other, now, on the basic terms of the deal. The lawyers can work out the “details” later—or so they hope.

\(^7^9\) RESTATEMENT (SECOND) OF CONTRACTS § 41(1) (1981) (“An offeree’s power of acceptance is terminated at the time specified in the offer, or, if no time is specified, at the end of a reasonable time.”). As noted in § 41(2) of the Restatement: “What is a reasonable time is a question of fact, depending on all the circumstances existing when the offer and attempted acceptance are made.”).
Recall that the jury in *Smith v. Sabine Royalty Corp.*[^80] found that Smith's January 9, 1975 "acceptance" was "within a reasonable time" from Sabine's November 7, 1974 letter.[^81] Although the jury was reversed, the fact it took a lawsuit to resolve the issue illustrates why a "reasonable time" should be avoided in most situations. For example, if the intent is to make an offer, but you do not want to have it lasting for an indefinite period of time, the offeror can provide:

This offer lapses on May 31, 2013 at 5:00 p.m. local Topeka, Kansas time.

b. Revocation

However, this language, standing alone, creates another problem: does the offeror intend to create an option contract giving the other party until May 31 to accept, during which time the offeror is unable to revoke its offer? If the subject matter of the contract is a sale of goods, or a lease of goods, the Uniform Commercial Code permits the creation of a "firm offer" without consideration.[^82] Instead of consideration, the Code requires the offer be made in a signed writing that "by its terms gives assurance that it will be held open . . . ."[^83] The interpretive issue then becomes whether merely specifying a date when the offer will lapse satisfies the "gives assurance that it will be held open." Although this language would not appear to satisfy the UCC, if the same issue were raised under an international transaction the answer would be different. For example, the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), at Article 16(2), provides an offer cannot be revoked "if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable . . . ."[^84] As with the lapse issue, this problem can be easily avoided through drafting:


[^81]: Id. at 369.

[^82]: U.C.C. § 2-205 (1977) provides:

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

Article 2A, regarding a lease of goods, contains a similar provision. U.C.C. § 2A-205.

[^83]: Id. (same language used in § 2-205 and § 2A-205).

This offer lapses on May 31, 2013 at 5:00 p.m. local Topeka, Kansas time. 
However, the offeror can revoke or modify this offer any time prior to its acceptance.

Once it is clear the offeror retains the right to revoke the offer, the next issue is when does the revocation take effect? For example, suppose on May 15, 2013 the offeror mails a letter to the offeree revoking the offer. The letter is received at the offeree’s place of business on May 18, 2013, but the offeree is out of town and does not read the letter until May 21, 2004. When was the revocation effective? May 15, May 18, or May 21? What if the offeree mailed an acceptance on May 15, 2013? On May 17? On May 20? Although there are rules to sort these issues out, the problem can be avoided by providing when a revocation takes effect and when an acceptance takes effect. To fully understand the problem, consider the default rules under the Restatement (Second) of Contracts. First, the Restatement provides:

An offeree’s power of acceptance is terminated when the offeree receives from the offeror a manifestation of an intention not to enter into the proposed contract. 85

Under this rule the revocation is not effective until received by the offeree. Therefore, the risk of transmission is on the offeror. A similar rule it applied under international contracting principles. 86 To shift this risk to the offeree, the offeror can provide:

Any revocation of this offer will be effective when the offeror mails or otherwise dispatches notice the offer is revoked. The revocation will be effective when properly dispatched, even though it is not received by the offeree.

85 Restatement (Second) of Contracts § 42 (1981) (emphasis added).

The Restatement defines “received” as follows:

A written revocation, rejection, or acceptance is received when the writing comes into the possession of the person addressed, or of some person authorized by him to receive it for him, or when it is deposited in some place which he has authorized as the place for this or similar communications to be deposited for him.

Restatement (Second) of Contracts § 68 (1981).

86 The UNIDROIT principles and the CISG both provide: “Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before it has dispatched an acceptance.” UNIDROIT, supra note 21, at Art. 2.4(1); CISG, supra note 56, at Art. 16(1).
c. Acceptance

The act of "acceptance" raises the next major issue. The offeror has it within their power to control what the offeree must do to effectively exercise a power of acceptance. This concept is reflected in *Restatement (Second) of Contracts* § 30 which provides:

(1) An offer may invite or require acceptance to be made by an affirmative answer in words, or by performing or refraining from performing specified act, or may empower the offeree to make a selection of terms in his acceptance. 87

(2) Unless otherwise indicated by the language or the circumstances, an offer invites acceptance in any manner and by any medium reasonable in the circumstances. 88

Consistent with the other "rules" in this area, the default rule is acceptance in any manner that is "reasonable in the circumstances." The offeror, however, is given the power to specify exactly what must be done to accept the offer. *Restatement (Second) of Contracts* § 60 states the principle as follows:

If an offer prescribes the place, time or manner of acceptance its terms in this respect must be complied with in order to create a contract. If an offer merely suggests a permitted place, time or manner or acceptance, another method of acceptance is not precluded. 89

The offeror will want to exercise this power so they know their contractual status at any given time. For example, a default rule most offerors will want to modify is the so-called "mailbox rule" which provides:

Unless the offer provides otherwise,

(a) an acceptance made in a manner and by a medium invited by an offer is operative and completes the manifestation of mutual assent as soon as put out of the offeree's possession, without regard to whether it ever reaches the offeror; but

87 Absent clear direction on the issue, § 32 of the *Restatement* provides: "In case of doubt an offer is interpreted as inviting the offeree to accept either by promising to perform what the offer requests or by rendering the performance, as the offeree chooses." *RESTATEMENT (SECOND) OF CONTRACTS* § 32 (1981).


89 *RESTATEMENT (SECOND) OF CONTRACTS* § 60 (1981).
(b) an acceptance under an option contract is not operative until received by the offeror.⁹⁰

This default rule places the risk of transmission on the offeror. To reverse this risk allocation, the offer can provide:

Acceptance of this offer will not be effective until actually received,⁹¹ and brought to the attention of, Larry Landman.

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⁹¹ Many laws define “receive.” For example, one of the more intricate definitions is found at §102 of the Uniform Computer Information Transactions Act which defines “receive” as “to take receipt.” § 102(54). “Receipt” is then defined as follows:

“Receipt” means:

(A) with respect to a copy, taking delivery; or

(B) with respect to a notice:

(i) coming to a person’s attention; or

(ii) being delivered to and available at a location or system designated by agreement for that purpose or, in the absence of an agreed location or system:

(I) being delivered at the person’s place of residence, or the person’s place of business through which the contract was made, or at any other place held out by the person as a place for receipt of communications of the kind; or

(II) in the case of an electronic notice, coming into existence in an information processing system or at an address in that system in a form capable of being processed by or perceived from a system of that type by a recipient, if the recipient uses, or otherwise has designated or holds out, that place or system for receipt of notice of the kind to be given and the sender does not know that the notice cannot be accessed from that place.

To avoid having to work through this sort of analysis, the parties can simply address the issue in their correspondence.
d. Acceptance by Conduct: A Contract Solution to the Tort of Trespass

Tort and contract interface in various ways. For example, an interesting remedy for a continuing trespass may be to turn it into a breach of contract. This was done by the surface owner in Russell v. Texas Company,92 where the oil and gas lessee was unlawfully using the leased land to support oil and gas operations on adjacent lands. When Russell discovered Texas Company was trespassing, Russell sent Texas Company an offer for a revocable license for $150.00 a day. The offer stated: "[Y]our continued use of the roadway, water and/or minerals will constitute your acceptance of this revocable permit."93 Texas Company continued to use the land for 24 days after it received the offer, and then Texas Company notified Russell his offer was rejected. The trial court awarded $3,600 to Russell holding Texas Company had accepted Russell’s offer by continuing to use the land after the offer was received. Texas Company argued it had no intent to accept Russell’s offer. Applying the Restatement (First) of Contracts § 72(2)94 the Court of Appeals held that Texas Company’s exercise of dominion over the land, after receiving the offer, was conduct manifesting its acceptance of Russell’s offer.95 The “true test” according to the court, even if the use was not tortious, was “whether . . . the offeror was reasonably led to believe that the act of the offeree was an acceptance . . . ”96 The test was met in this case.

92 238 F.2d 636 (9th Cir. 1956).
93 Id. at 641.
94 The Restatement (First) of Contracts § 72(2) states:

Where the offeree exercises dominion over things which are offered to him, such exercise of dominion in the absence of other circumstances showing a contrary intention is an acceptance. If circumstances indicate that the exercise of dominion is tortious the offeror may at his option treat it as an acceptance, though the offeree manifests an intention not to accept.

The counterpart to this section in the Restatement (Second) of Contracts states:

An offeree who does any act inconsistent with the offeror’s ownership of offered property is bound in accordance with the offered terms unless they are manifestly unreasonable. But if the act is wrongful as against the offeror it is an acceptance only if ratified by him.

95 238 F.2d at 642.
96 Id. at 643.
e. Notice of Acceptance

In most instances the parties create a bilateral contract in which notice the offeree is accepting the offer is conveyed immediately to the offeror. In those rare situations where the offeror will not be informed of the other party’s acceptance, the Restatement provides:

Except as stated in § 69⁹⁷ or where the offer manifests a contrary intention, it is essential to an acceptance by promise either that the offeree exercise reasonable diligence to notify the offeror of acceptance or that the offeror receive the acceptance seasonably.⁹⁸

The notice issue arises most often when the offeree is required or authorized to accept by performing an act, but knowledge of the act will not be known by the offeror unless brought to their attention by the offeree. Although the acceptance is effective when the act is performed, a failure to notify the offeror of the acceptance in a timely manner allows the offeror to avoid their contractual obligations. The Restatement rule on this topic provides:

(2) If an offeree who accepts by rendering a performance has reason to know that the offeror has no adequate means of learning of the performance with reasonable promptness and certainty, the contractual duty of the offeror is discharged unless

(a) the offeree exercises reasonable diligence to notify the offeror of acceptance, or

(b) the offeror learns of the performance within a reasonable time, or

(c) the offer indicates that notification of acceptance is not required.⁹⁹

These problems can be avoided by simply providing for notification, or no notification, in the correspondence. In many instances the issue will not need to be addressed because compliance with the stated mode of acceptance will incorporate an actual notice requirement.

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⁹⁷ Section 69 addresses the exceptional situations when a failure to speak—silence—will be an acceptance. The basic rule is that an offeree’s failure to respond to an offer is not an acceptance. The exceptions include situations such as an express agreement of the parties on the matter, or prior dealings that give rise to a duty to speak. Restatement (Second) of Contracts § 69 (1981).

⁹⁸ Restatement (Second) of Contracts § 56 (1981).

⁹⁹ Restatement (Second) of Contracts § 54 (1981).
2. Soliciting the Offer: Management Approval Clause

One of the best ways for the offeror to control the situation is to put themself in the position of the offeree, while specifying the terms of their own offer. This is typically known as the “home office approval” approach to contracting. Instead of making an offer to the other party, the deal is structured so that when the other party signs the document it becomes their offer for the tendering party’s acceptance or rejection. However, as with any situation where the final manifestation of assent is delayed, either party is free to walk away from the proposed deal. But in most instances, the management approval clause is desired to control the process and absolutely necessary when conducting negotiations through employees or agents who are not authorized to make the deal.

The specific action that “management” must take to effect an approval, and therefore an acceptance, must be carefully defined. If it is not, the “approval” may take place at some undesired time prior to the act of the appropriate manager signing on the dotted line. This was a $1.45 million problem for a gas purchaser in Manchester Pipeline Corp. v. Peoples Natural Gas Co. where Peoples sent copies of an unsigned Gas Purchase Contract to Manchester with a letter stating:

“Enclosed for your review and approval, please find three copies of our Gas Purchase Contract covering acreage referenced above.

“If you find this Contract acceptable, please fully execute all three copies, (including notary pages) and return to this office. Following [PNG’s] execution, one completed Contract will be forwarded to you.”

This letter was sent on September 12, 1984, the contracts were executed by Manchester and returned on September 18, 1984, but “PNG never executed the copies and denied that a contract for the purchase of gas has even been formed between the parties.” The gas market was rapidly deteriorating in the Fall of 1984 and PNG decided it really didn’t want to enter into the 10-year take-or-pay contract it had been negotiating with Manchester since November 1983.

Peoples argued the contract signed by Manchester was merely an offer which was not accepted by Peoples, because it never signed it. In a letter dated October 29, 1984, Peoples informed Manchester “there would be no binding contract until PNG’s management signed and executed the Document, and advising Manchester not to proceed with installation of the pipeline

100 862 F.2d 1439 (10th Cir. 1988).

101 Id. at 1441.

102 Id.
until PNG’s management had done so.”\textsuperscript{103} However, when the jury considered the issue, it accepted Manchester’s argument that when People’s sent the three copies of the contract for Manchester’s execution, that was an offer by People’s which was accepted by Manchester when it signed and returned the documents. The factual issue was whether Manchester had “reason to know” that Peoples did not intend to create a power of acceptance in Manchester, but rather sought to solicit an offer which could only be accepted by the formal act of Peoples’ management signing the documents.\textsuperscript{104} It would have been easy to control what Manchester had “reason to know” in the correspondence leading up to sending the three copies of the contract. For example, consider the following:

By signing the three copies of the enclosed Gas Purchase Agreement, you are making an offer to Peoples for consideration by its senior management. Until and unless approved by Peoples’ management, and the Gas Purchase Agreement is signed by Peoples’ Vice President for Gas Acquisition, this offer will not become a contract.

3. Managing the Acceptance: Rejection, Counter-Offer

a. Rejection

A person’s power of acceptance is extinguished once they reject the offer.\textsuperscript{105} The Restatement provides:

(1) An offeree’s power of acceptance is terminated by his rejection of the offer, unless the offeror has manifested a contrary intention.

(2) A manifestation of intention not to accept an offer is a rejection unless the offeree manifests an intention to take it under further advisement.\textsuperscript{106}

\textsuperscript{103} \textit{Id.} at 1442. Of course this letter would have no effect if an offer existed that was accepted by Manchester in September.

\textsuperscript{104} \textit{Id.} at 1445.

\textsuperscript{105} However, if the offer is made as an option contract, the Restatement (Second) of Contracts provides: “the power of acceptance under an option contract is not terminated by rejection or counter-offer, by revocation, or by death or incapacity of the offeror, unless the requirements are met for the discharge of a contractual duty.” \textit{Restatement (Second) of Contracts} § 37 (1981) (emphasis added). Although the power of acceptance is not terminated, there could be instances where the party upon being informed of the rejection may take action in reasonable reliance on the representation.

\textsuperscript{106} \textit{Restatement (Second) of Contracts} § 38 (1981).
Often it is difficult to determine the status of a rejection because the offeror, upon receiving the rejection, may actually renew the offer by saying, for example: "just think about it a while and let me know." It is also possible for the offeree to open up a parallel line of negotiation without rejecting the offer that is on the table. For example, the offeree might say: "Without addressing your offer, and keeping it under further advisement, I would like to see if you would take $10,000 in cash to right now to close the deal."

When a rejection is intended by the offeree, the rejection will take effect, under the Restatement rule, only upon receipt by the offeror.107 Frequently, however, the correspondence giving right to a rejection by the offeree may also create a new power of acceptance in the original offeror: a counter-offer.

b. **Counter-Offer**

A counter-offer is a rejection of the pending offer and the creation of a new offer by the rejecting party. The Restatement describes it as follows:

(1) A counter-offer is an offer made by an offeree to his offeror relating to the same matter as the original offer and proposing a substituted bargain differing from that proposed by the original offer.

(2) An offeree’s power of acceptance is terminated by his making of a counter-offer, unless the offeror has manifested a contrary intention or unless the counter-offer manifests a contrary intention of the offeree.108

The counter-offer continues negotiations between the parties. For example, in *Smith v. Des Marteau*,109 the parties exchanged ten letters regarding the purchase of a mineral interest. Throughout the negotiations the buyer offered to buy at $1600 while the seller agreed to sell at $1600 “net” to her. Ultimately the difference between $1600 and $1600 net would be the abstracting costs, which amount was later determined to be $12.50.110 Before they were able to

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107 Restatement § 40 provides:

Rejection or counter-offer by mail or telegram does not terminate the power of acceptance *until received by the offeror*, but limits the power so that a letter or telegram of acceptance started after the sending of an otherwise effective rejection or counter-offer is only a counter-offer unless the acceptance is received by the offeror before he receives the rejection or counter-offer.


109 199 P.2d 1006 (Colo. 1948).

110 Id. at 1009-10.
agree, the seller elected to break off negotiations. No contract was created; the parties had merely exchanged a series of offers and count-offers prior to the seller’s decision not to sell.

In the comments to the Restatement it cautions that minor variation in how a matter is proposed can make it a counter-offer, or merely an exploration of other possibilities, without the intent to reject the offeror’s pending offer. For example, in comment b. it is provided:

A mere inquiry regarding the possibility of different terms, a request for a better offer, or a comment upon the terms of the offer, is ordinarily not a counter-offer. Such responses to an offer may be too tentative or indefinite to be offers of any kind; or they may deal with new matters rather than a substitution for the original offer; or their language may manifest an intention to keep the original offer under consideration.¹¹¹

D. Battle of the Forms

Article 2 of the Uniform Commercial Code modifies the traditional contract law principle that a purported acceptance of an offer, which is not on the “mirror image” terms of the offer, is not an “acceptance” but rather a “rejection.” Under non-sales law this gave rise to the “last shot” rule that the party “firing” (making) the “last shot” (offer), preceding someone’s performance, would have a contract on their “last shot” terms. This is because performance, following receipt of the last un-rejected offer, was viewed as an act of acceptance.

However, if the non-conforming offer concerns a contract for the sale of goods, a special provision of Article 2, designed to mitigate the “mirror image” rule, will often give rise to a contract before the act of performance that would have otherwise been the acceptance. UCC § 2-207 is designed to mediate the “battle of the forms” when parties to a sale exchange documents that contain diverging terms, but they nevertheless proceed with the transaction as though they are in agreement. The first subsection of § 2-207 provides:

A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.¹¹²

Assuming the battling forms satisfy a “definite and seasonable expression of acceptance,” they will give rise to a contract even though the acceptance document “states terms additional to or different from those offered . . . .” This has generally been interpreted as giving rise to a contract, so long as the terms the parties chose to focus on in their negotiations agree. This is the required

¹¹¹ Id. at comment b.

“expression of acceptance.” Other important terms, that do not agree, but were not the focus of the negotiations, will not prevent the formation of a contract. For example, if the parties specifically negotiated the volume, price, and delivery of gas, a contract could arise as to those terms even though other terms, such as warranties and indemnities, do not agree.

The second subsection of § 2-207 addresses the effect of these other terms, where the offer and acceptance do not agree:

The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;
(b) they materially alter it; or
(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.\(^{113}\)

The key provision is that the additional terms are mere “proposals” which will not become part of the contract unless there is additional assent to the proposal. Their existence will not prevent the formation of a contract, but they will not become part of the contract that is formed.\(^{114}\)

Major controversy has focused on the effect of having “different” material terms in the accepting document.\(^{115}\) This has given rise to two responses to different terms: one approach favors the offeror and is known as the “drop out” rule; the other favors the accepting party, and is known as the “knock out” rule. Under the drop out rule the different terms in the acceptance merely “drop out” of the deal and have no effect on the offer. Under the knock out rule the different terms in the acceptance do not become part of the deal, but they “knock out” the different terms contained in the offer.\(^{116}\)

The third subsection of § 2-207 provides:

\(^{113}\) U.C.C. § 2-207(2) (1977).

\(^{114}\) If the offer and acceptance documents pass between “merchants” then any non-material term can become part of the contract unless the other party objects to the “additional” terms “within a reasonable time . . . .” U.C.C. § 2-207(2)(b). The significance of this provision hinges on what is a “material” term.

\(^{115}\) For a collection and analysis of cases lining-up the competing approaches in various states, see Richardson v. Union Carbide Industrial Gases, Inc., 790 A.2d 962, 966-968 (N.J. Super. 2002) (identifying the “knock out” rule as the majority rule and adopting the rule as the law in New Jersey).

\(^{116}\) See generally E. Allan Farnsworth, Contracts § 3.21, pp. 161-170 (4\(^{th}\) ed. 2004) (section titled “Battle of the Forms” with the specific discussion of the “knock out” rule at pp. 164-165).
Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.\textsuperscript{117}

This subsection provides for situations where the terms of the documents do not reflect an “expression of acceptance” on the basic deal, but the parties nevertheless proceed as though they have a contract. This can also arise when one of the parties seeks to use a defensive clause designed to prevent the formation of a contract under subsections (1) or (2). For example, subsection (2) allows the offeror to prevent the formation of a contract by stating, in the offer: “this offer is expressly limited to the terms of the offer.”\textsuperscript{118} Similarly, subsection (1) allows the accepting party (the offeree) to prevent the formation of a contract by stating, in the acceptance: “acceptance is expressly made conditional on assent to the additional or different terms.”\textsuperscript{119} When the third subsection is triggered, the offeree is effectively able to cancel out the offeror’s terms much the same way as does the “knock out” rule under subsection two.\textsuperscript{120}

Although the 2003 revisions to Article 2 have not been adopted by any state (and are not now likely to be adopted), it is informative to note how they would have made major changes to § 2-207 by, in effect, adopting an analysis very similar to the original version of subsection three of § 2-207. The 2003 revisions to § 2-207 would provide that:

\begin{quote}
If (i) conduct by both parties recognizes the existence of a contract although their records\textsuperscript{121} do not otherwise establish a contract, (ii) a contract is formed by an offer and acceptance,\textsuperscript{122} or (iii) a contract formed in any manner is confirmed by a record that contains terms additional to or different from those in the contract being confirmed, the terms of the contract, are:
\end{quote}

\textsuperscript{117} U.C.C. § 2-207(3) (1977).

\textsuperscript{118} U.C.C. § 2-207(2)(a) (1977).

\textsuperscript{119} U.C.C. § 2-207(1) (1977).

\textsuperscript{120} The offeree, by proposing terms that prevent the writings of the parties from “agreeing,” negates not only the offeree’s terms, but also those of the offeror.

\textsuperscript{121} “Record” is defined as “information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.” U.C.C. § 1-201(31) (this revised version of Article 1 has been adopted by over 40 states).

\textsuperscript{122} Revised UCC § 2-206(3) provides: “A definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer.”

34
(a) terms that appear in the records of both parties;
(b) terms, whether in a record or not, to which both parties agree; and
(c) terms supplied or incorporated under any provision of this Act.\(^{123}\)

Once a contract is found to exist, § 2-207 identifies how the terms of the contract will be ascertained. It is not necessary to distinguish “material” from non-material terms. Instead, the analysis will focus on identifying terms that are found in both records and terms to which the parties agree upon. Professor Farnsworth offers the following interpretation of the “parties agree” element of the test:

[B]y asking a court to determine under (b) whether a party “agrees” to the other party’s terms, the revised section gives courts discretion in including or excluding terms in a manner different from the more mechanical rules of the original section. A court might, for example, find that parties agreed to arbitration even though the arbitration provisions in their forms differed in minor respects.\(^{124}\)

This avoids the “all-or-nothing” results under either the “knock out” or “drop out” rules and allows the court to fashion, when feasible and consistent with the intent of the parties, a hybrid provision with elements to which both parties indicated agreement.

Although § 2-207, whether original or revised, is commonly viewed in the context of a battle of the “forms,” the analysis is not limited to “form” documents but applies to any actions between the parties that give rise to contract-formation issues. The major change made by the revised § 2-207 is, in the words of Professor Farnsworth: “intended to give no preference to either the first form, as did UCC-O [original] 2-207 or the last form, as did the common law.”\(^{125}\)

Sales of goods are often be made quickly through an exchange of documents purporting to be an offer and acceptance. Disputes over the existence and terms of a sales contract typically arise after some degree of performance has taken place. In such cases the issue will be whether a contract exists under the first two subsections of § 2-207, or the third subsection. Depending upon which subsection applies, the contract may be driven by either the offeror’s terms\(^{126}\) or terms on which the forms of the parties agree, plus any terms provided by the gap-filler provisions of the UCC. If either party finds these situations unacceptable, they must be prepared to police the documents they receive to ensure either: (1) unacceptable offers or “acceptances”

\(^{123}\) U.C.C. § 2-207 (proposed revised version).

\(^{124}\) E. Allan Farnsworth, Contracts 170 (4th ed. 2004).

\(^{125}\) Id.

\(^{126}\) Assuming a contract was formed under the § 2-207(1) & (2) analysis and the “knock out” rule does not apply.
are rejected and the contracting process restarted until there is true agreement; or (2) performance follows the issuance of your new offer.\textsuperscript{127}

E. Consideration Issues

The *Restatement (Second) of Contracts* continues the basic bargain theory of consideration, by providing, in part:

(1) To constitute consideration, a performance or a return performance must be bargained for.

(2) A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise.

(3) The performance may consist of

(a) an act other than a promise, or

(b) a forbearance, or

(c) the creation, modification, or destruction of a legal relation.\textsuperscript{128}

In the exploration arena, consideration issues arise in two general situations: (1) the illusory agreement where one party is obligated to do something and the other party has not limited their freedom to act in any real manner; and (2) modifications to an existing contract.

Many clients often seek ways to keep the other party on the hook while they retain unfettered freedom whether to perform an agreement. The problem is that when it matters, if the

\textsuperscript{127} If all prior offers are *clearly rejected*, this allows the party issuing the next document to be the new offeror (thereby “restarting” the process). If the other party performs after receiving this new offer, and without tendering any sort of conflicting terms in response to the offer, the UCC will recognize the resulting contract. U.C.C. § 2-204(1) (original version) states: “A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.” UCC § 2-204(1) (revised version) is more explicit and states: “A contract for sale of goods may be made in any manner sufficient to show agreement, *including offer and acceptance*, conduct by both parties which recognizes the existence of such a contract, the interaction of electronic agents, and the interaction of an electronic agent and an individual.” (Emphasis added).

\textsuperscript{128} *Restatement (Second) of Contracts* § 71 (1981).
client is not bound, neither is the other party.\textsuperscript{129} Instead of going through the tortured process of trying to manufacture an obligation when none exists, clients should consider the device designed to allow them to think it over while the other party is locked into an offer: the option contract. It is probably one of the more under-used devices to commit a party to an offer while the other party considers its options. Most courts, and the Restatement (Second) of Contracts, even apply a less rigorous consideration requirement for option contracts.\textsuperscript{130} The Uniform Commercial Code recognizes a merchant's "firm offer" without consideration,\textsuperscript{131} and in the international arena the consideration requirement to hold open an offer has been eliminated entirely.\textsuperscript{132}

F. Modification

Modification frequently arises as an issue when a service provider arrives on site to do work and thrusts a "work order," "work ticket," or similarly-innocuously-sounding document in the face of a field employee to sign. The field employee signs the work order, most likely to acknowledge that the service company representative indeed arrived at the work site. These situations present two issues: First, does the field employee have any authority to alter a pre-existing contract created by his or her employer? This is a basic agency issue. Second, assuming the employee has the requisite authority, has there been an effective modification of the pre-existing contract? This re-triggers all the basic contract formation issues, including mutual assent, consideration, and defenses to defective bargaining, such as mistake and unconscionability.

\textsuperscript{129} Most recently this has been demonstrated by disputes over the use of sight drafts and whether the lessee has effectively limited its ability to walk away from a proposed leasing transaction.

\textsuperscript{130} Restatement (Second) of Contracts § 87 (1981) ("An offer is binding as an option contract if it . . . is in writing and signed by the offer, recites a purported consideration for the making of the offer, and proposes an exchange on fair terms within a reasonable time . . . .")

\textsuperscript{131} U.C.C. § 2-205 (1977) provides:

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

(Emphasis added).

\textsuperscript{132} The CISG provides "an offer cannot be revoked . . . if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable . . . ." CISG, supra note 56, Art. 16(2)(a).
For example, in *Belger Cartage Service, Inc. v. Holland Construction Company*,133 Holland's foreman ordered a crane from Belger's dispatcher, apparently over the telephone. Several days later, before the work was to be performed, the dispatcher filled out a "work order form" which was taken by the crane operator to the work site. The precise procedure used to sign the work order was in dispute, but apparently it was signed by Holland's foreman. The reverse side of the work order contained ten paragraphs of "small print . . . attempting to establish the rights and obligation between the parties with respect to the use of the crane."134 While lifting Holland's equipment, the cable broke causing damage to the crane and to the equipment it was lifting. The "small print" on the work order would make Holland responsible for all damages associated with the accident and absolve Belger of all liability. The trial court gave no effect to the terms on the back of the work order and concluded: "The work order form signed by plaintiffs dispatcher and defendant's foreman was just that[,] an order for the lease of equipment at a certain time and an acknowledgement of the receipt of the equipment."135 The court held the terms on the back of the work order had no effect on the parties' legal relations.

The Kansas Supreme Court affirmed the trial court's holding, but rejected the public policy basis for the court's ruling. The trial court had found that many of the terms on the back of the work order violated public policy and were therefore unenforceable. The Supreme Court believed the parties had the ability to agree to the terms, but held there had been no agreement, as to the disputed terms, because: "There was no evidence that the clauses were discussed or that Holland had actual knowledge thereof."136 This appears to be a mutual assent analysis: the parties agreed to a contract with terms A, B, and C, but not a contract with terms D through Z that were written on the back of the work order. An alternative analysis could find that an oral contract was made by the parties when they first agreed upon the services to be provided, the price, and the date, place, and time of performance. When the new work order terms were presented at the job site, this was a request for a modification of the existing oral contract. This raises consideration issues.

At common law the agreement to forego a contractual right required consideration to be enforceable. For example, assume a party to a farmout agreed to test a formation in order to earn rights in the formation. The farmee asks their farmor if he can be relieved of the testing requirement on specified formations, but nevertheless still earn rights in the formation. The farmor agrees, but changes his mind before the farmee has detrimentally relied on the agreement. The farmor is not bound by its modification agreement because it was not supported by consideration. Although the farmor agreed to give up its contractual right to insist that the farmee test-to-earn rights in a formation, the farmee gave up nothing in return.

133 582 P.2d 1111 (Kan. 1978).

134 *Id.* at 1113.

135 *Id.* at 1114.

136 *Id.* at 1120.
Although most states still require consideration to support a modification, the Restatement (Second) of Contracts has eliminated the requirement by providing:

A promise modifying a duty under a contract not fully performed on either side is binding

(a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or

(b) to the extent provided by statute; or

(c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise. 137

If the contract concerns a sale of goods, Uniform Commercial Code § 2-209 provides: “An agreement modifying a contract within this Article needs no consideration to be binding.” 138 However, the comment to 2-209 states it applies only to a modification made in “good faith.” 139 The CISG follows the UCC’s approach in § 2-209. 140 Presumably, if the modification is the product of having a field employee sign a work order, containing new terms that no one expected to be focused on or read, it may not be “fair and equitable” or to have been obtained in “good faith.” In this context the concepts of “fair and equitable” and “good faith” would appear to allow a court to focus on these “procedural” aspects of how the party went about obtaining the other party’s “assent” to the modification.

At common law, parties to a written agreement can modify it orally, even though it contains a “no oral modification” clause. For example, in Ruby Drilling Co. v. Duncan Oil Co., Inc., 141 the drilling contract stated: “Any alternation or deviation from above specifications involving extra costs, will be executed only upon written orders . . . .” 142 The driller argued the “footage” drilling contract was modified by the parties into a “daywork” contract when the hole

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137 Restatement (Second) of Contracts § 89 (1981).
139 Id. at cmt. 2.
140 CISG, supra note 56, Art. 29(1) (“A contract may be modified or terminated by the mere agreement of the parties.”).
141 47 P.3d 964 (Wyo. 2002).
142 Id. at 967.
began to substantially deviate from the vertical. The court first stated the basic rule regarding oral modifications:

[Parties to a written agreement may orally waive or modify their rights under the agreement. We have further indicated that an oral modification of a written agreement may be possible even when the agreement contains a no-unwritten-modification clause. The party asserting that a written agreement was modified by the subsequent expressions or conduct of the parties must prove so by clear and convincing evidence.]

In this case the court found the evidence of an oral modification clearly unconvincing and enforces the written footage drilling contract.

G. Waivers

Although an attempted modification of a contract may not be effective, the actions of a party may constitute a waiver of the right to enforce the contract. For example, in Congress Talcott Corporation v. Shapiro, the court held: “Although an oral agreement would not be effective to modify the delivery terms of the original contract (UCC § 2-209[2]), the proof established that the original contract delivery date had been waived by an executed oral modification...”

If the agreement concerns a sale of goods, the no-oral-modification clause is elevated to a private statute of frauds. As noted previously, UCC § 2-209(1) has substituted a signed writing for consideration to validate contract modifications not supported by consideration. To further support this “form” substitute for consideration, UCC §2-209(2) states, in part: “A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded...” The balance of § 2-209, however, mitigates even this requirement by recognizing the requirement can be “waived” or the party can seek relief due to their reasonable reliance on the oral modification. Even though a party is able to overcome

\[143\] Id. at 968.
\[144\] Id. at 969.
\[146\] Id. at 733.
\[147\] U.C.C. § 2-209(2) (1977). The international counterpart to the UCC has a similar provision. CISG, Art. 29(2).
the consideration and no-oral-modification private statute of frauds, the contract, as modified, must still satisfy any statutory or common law statute of frauds.\textsuperscript{149}

H. Statute of Frauds

To properly resolve statute of frauds issues, the subject matter of the contract must be properly classified to ensure the appropriate body of contract law is being applied. For example, a sale of goods,\textsuperscript{150} lease of goods,\textsuperscript{151} service agreements,\textsuperscript{152} land transactions,\textsuperscript{153} consumer transactions, and other agreements identified by a legislature for special treatment, all have their own unique statute of frauds requirements. Many of these requirements are derived from the original English Statute of Frauds of 1677. For example, Section 4 of the Statute provides, in part:

\begin{quote}
And be it further enacted . . . that . . . no action shall be brought . . . (4) upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them . . . unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized.
\end{quote}

Parties may engage in negotiations and at some point, prior to the preparation of a final written document, a party will break off negotiations. This will often prompt one of the parties to assert a contract has already been formed. The focus will then shift to whether any writing exists that satisfies the statute of frauds. For example in \textit{EP Operating Co. v. MJC Energy Co.},\textsuperscript{154} one party sought to rely on a series of letters to satisfy the statute of frauds. However, none of the letters contained language indicating an acceptance of the offer, but instead merely continued negotiations toward a possible agreement.\textsuperscript{155} The court explained:

\begin{quote}
The statute of frauds requires the written agreement or memorandum to be complete within itself in every material detail and to contain all of the essential elements of
\end{quote}

\begin{flushright}
\textsuperscript{149} \textit{Id. at § (3).}
\end{flushright}

\begin{flushright}
\textsuperscript{150} U.C.C. § 2-201 (1977) (writing when price of $500 or more).
\end{flushright}

\begin{flushright}
\textsuperscript{151} U.C.C. § 2A-207 (1987) (writing when total amount is $1,000 or more).
\end{flushright}

\begin{flushright}
\textsuperscript{152} Often no writing will be required if the contract can be performed within one year form the date it is made. Section 5 of the English Statute of Frauds.
\end{flushright}

\begin{flushright}
\textsuperscript{153} Writing required. Section 4 of the English Statute of Frauds.
\end{flushright}

\begin{flushright}
\textsuperscript{154} 883 S.W.2d 263 (Tex. Ct. App. 1994).
\end{flushright}

\begin{flushright}
\textsuperscript{155} \textit{Id. at 267.}
\end{flushright}
the agreement so that the contract can be ascertained from the writings without resort to oral testimony.\textsuperscript{156}

For example, a signed writing agreeing to enter into "an 88 form lease" on specifically described land was not enforceable, under the statute of frauds, because the terms of the required lease could not be ascertained from the writing.\textsuperscript{157} Another context in which the statute of frauds frequently is an issue concerns property descriptions. For example, in \textit{Westland Oil Development Corp. v. Gulf Oil Corp.},\textsuperscript{158} the court considered whether the impacted land in an area of mutual interest clause was sufficiently identified to satisfy the statute of frauds. The area of mutual interest was described as follows:

\begin{quote}
If any of the parties hereto, their representatives or \textit{assigns}, acquire any additional leasehold interests affecting any of the lands covered by said farmout agreement, or any additional interest from Mobil Oil Corporation under lands in the area of the farmout acreage, such shall be subject to the terms and provisions of this agreement . . . \textsuperscript{159}
\end{quote}

The court held the portion of the AMI described as "lands covered by said farmout agreement" were adequately described while "lands in the area of the farmout acreage" were not adequately described. In this case the "farmout agreement" contained a detailed description of the lands it covered, but there was not any way of defining the extent of land in the "area of the farmout acreage."\textsuperscript{160}

Related to the statue of frauds is the obligation of the party asserting rights under a contract to establish its terms. For example, in \textit{Baker Hughes Oilfield Operation v. Flash Oil & Gas Southwest, Inc.},\textsuperscript{161} the plaintiff sued seeking damages associated with well services provided by Baker Hughes. In a motion for partial summary judgment Baker Hughes sought to rely upon its "standard Terms and Conditions" that it includes as part of all its contracts. However, Baker Hughes was unable to prove that its "Terms and Conditions" were ever provided to the plaintiff. The court noted:

\begin{quote}
It is undisputed that a contract was formed; Flash called Baker Hughes out to perform the proposed work and provide the discussed services, and it was Baker
\end{quote}

\textsuperscript{156} \textit{Id.}.

\textsuperscript{157} Fagg v. Texas Co., 57 S.W.2d 87, 89 (Tex. Comm'n App. 1933).

\textsuperscript{158} 637 S.W.2d 903 (Tex. 1982).

\textsuperscript{159} \textit{Id.} at 905.

\textsuperscript{160} \textit{Id.} at 906.

\textsuperscript{161} No. 04-2295, 2007 WL 1551057 (W.D. La. May 25, 2007).
Hughes' undertaking of same which led to the case at bar. However, the terms of
the contract in force or exactly what contract is in force is certainly contested.
Regardless, one of the parties to the contract, Flash, denies ever receiving the
written, electronic contract and the party seeking to enforce that contract and its
particular Terms and Condition provision, Baker Hughes, cannot provide any
evidence that the alleged contract was either sent, received or accepted.\(^{162}\)

The court concluded there was no evidence that the Terms and Conditions ever became part of
the contract and therefore could not be used to limit the plaintiff's rights.\(^{163}\)

III. DOCUMENTING RELATIONSHIPS: THE "WAIVER AGREEMENT"

Often a simple agreement can avoid all sorts of problems, particularly when dealing with
sensitive pre-exploration information. In this section we consider the $4 million "waiver
agreement." Suppose a geologist generates an idea, a theory about the location of new, yet-to-be
discovered, oil and gas deposits. He approaches an oil company already active in the area and
makes a presentation in which he shares his theories and seeks to sell his "prospect" to the
compny. The company's exploration manager and the geologist share information but the
manager does not agree with the geologist's interpretation, and tells the geologist the company is
not interested in his prospect. Four months later the state offers several tracts of land for lease,
some of which are within the prospect area the geologist discussed. The company acquires
leases, in the state lease sale and within the prospect area, for $540,000. The geologist sues
asserting the company breached a confidential relationship with the geologist pleading theories
in negligence, gross negligence, fraud, and misappropriation of a trade secret. The jury finds for
the geologist and awards $1,430,000 in actual damages and $2,600,000 in punitive damages.
During the litigation the company let the leases it acquired for $540,000 expire because it did not
want to drill while this dispute was pending. This would be the end of the story, if there had been
no agreement between the parties.

The facts are taken from \textit{Unocal Corp. v. Dickinson Resources, Inc.},\(^{164}\) in which, but for
a "waiver agreement," the jury's verdict may have been upheld.\(^{165}\) However, the Court of
Appeals reversed, relying upon a letter which the company required the geologist to sign before
the company would listen to the geologist's presentation, or look at his data. The letter stated:

\(^{162}\) Id. at *5.

\(^{163}\) Id. at *6.

\(^{164}\) 889 S.W.2d 604 (Tex. Ct. App. 1994).

\(^{165}\) Unocal argued it did not rely upon the geologist's theories or information but instead acquired
the leases based upon a study it had commenced two years prior to the meeting, and had only
recently completed. It also acquired new seismic data on the area prior to the lease sale. Perhaps
most notable, Unocal had up to 300 producing wells, and had drilled 800 wells, in the general
area. \textit{Id.} at 606-07. The jury apparently was not impressed.
This letter is written in connection with the review by Union . . . of certain geologic and/or geophysical data and/or land and leasehold information provided by your company.

You agree to waive any claim demand or cause of action, either legal or equitable, which may be asserted against . . . Union concerning use of any data or information of a proprietary or confidential nature which is provided for review by . . . Union. Such review by . . . Union shall not preclude any oil and gas operation or activity subsequent to the review in any area which was subject to the review, or in any other area.\(^{166}\)

The court reversed and entered judgment for Unocal Corp., holding the waiver barred all of the geologist’s claims.\(^{167}\) Commenting on the wisdom of such agreements, the court observed:

From Unocal’s perspective, it is easy to see why it required the waiver form. It sought to prevent exactly what occurred in this case: a claim that it “stole” an idea, prospect, data or information, whatever it is called. Without such agreements, an exploration company such as Unocal would never meet with a vendor such as DRI because of the risk of claims like the kind DRI has made here.\(^{168}\)

**IV. WHAT IS THE CONTRACT? WHAT DOES IT MEAN?**

Although exploration seems to generate a large number of contract formation issues, it also generates a substantial number of interpretive issues. Contract interpretation is perhaps one of the most confusing areas of the law—or at least the most difficult to try and reconcile the case law. I believe most of the confusion is caused by courts picking-and-choosing, and manipulating, “rules” used to interpret contracts. For example, most jurisdictions have an irreconcilable collection of cases addressing when, and to what extent, extrinsic evidence can be used to determine the “meaning” of a contract. Typically the ambiguous threshold of “ambiguity” is

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\(^{166}\) Id. at 607.

\(^{167}\) The court states:

> We conclude the waiver is binding and bars all of DRI’s [the geologist’s] claims. The waiver specifically provided that review of DRI’s data did not preclude *any oil and gas operation or activity in any area*. This language is clear. The waiver extinguished DRI’s right to sue Unocal as effectively as a prior judgement between the parties.

*Id.* at 610.

\(^{168}\) *Id.* at 609.
employed to marshal the evidence, with the court as the arbiter of what is, and is not, ambiguous—and therefore what will, and will not, be considered in ascertaining the intent of the parties. If the process becomes too transparent, the court can drag out the parol evidence rule to further confuse the situation. Equity is alive and well in contract interpretation.  

When approaching an interpretation problem, consider the following organizing principles: First, the parol evidence rule should be used only to determine the universe of terms that comprise the contract. The parol evidence rule does not deal with what the terms mean; it just identifies the terms that are available for interpretation.  

The parol evidence rule seeks to give effect to any final written agreement the parties intend to adopt as either their partial or complete integrated agreement. This issue frequently arises in oil and gas cases where it may be expressed in terms of “merger.” For example, in Avien Corp. v. First National Oil, Inc., the court had to consider whether limiting language in a farmout agreement could be considered in interpreting an assignment earned pursuant to the farmout. The court correctly noted “the merger doctrine is based on the intention of the parties” and “[i]ntent is a question of fact to be determined from the written instrument as well as the facts and circumstances surrounding its execution.” In the Avien case the terms of the “written instrument,” the assignment, were particularly helpful because, as the court noted: “The assignment document was expressly made subject to the farmout agreement.” However, even absent this express language, the court should be willing to consider extrinsic evidence to ascertain the parties’ intent regarding merger.  


170 This topic is discussed extensively, with oil and gas law examples, in: David E. Pierce, Defining the Role of Industry Custom and Usage in Oil & Gas Litigation, 57 SMU L. REV. 387, 393-403 (2004).  


172 Id. at 227 (emphasis added).  

173 Id. The court uses this language to arrive at the following conclusion:  

The purpose of making a document subject to another document is to keep the first document controlling over the second document. Using a plain meaning analysis, it is clear that the parties did not intend the farmout agreement to be merged with the assignment.  

Id.  

174 “Merger” is the property law context of the parol evidence rule. Finding that the terms of a contract have merged into a conveyance is similar to the contract context of concluding the parties intended the final writing to be a completely integrated statement of their agreement.
Once the terms of the contract are identified, the second step is to ascertain their meaning. This is where courts continue to suffer from the assumption that a judge can simply look at a word on paper and determine what it means—unless it is ambiguous—in which case they can consider extrinsic evidence to aid their interpretation. The *Restatement (Second) of Contracts* adopts the more realistic view of Professor Corbin on this subject, by providing:

Agreements and negotiations prior to or contemporaneous with the adoption of a writing are admissible in evidence to establish

(a) that the writing is or is not an integrated agreement;

(b) that the integrated agreement, if any, is completely or partially integrated;

(c) the meaning of the writing, whether or not integrated;

(d) illegality, fraud, duress, mistake, lack of consideration, or other invalidating cause;

(e) ground for granting or denying rescission, reformation, specific performance, or other remedy.\(^{175}\)

When the purpose of interpretation is properly identified—ascertaining the intent of the parties—courts should be able to consider any relevant evidence bearing on the question.\(^{176}\)

V. CONCLUSIONS

Using this article, professionals who draft and administer contracts should be able to evaluate the contract formation practices of their clients and employers to identify those that may need attention. The goal is simple: be able to clearly and definitively ascertain, at any moment in time, the status of all parties throughout the contract formation process. To do this, you must know the precise collection of laws that apply to the proposed transaction. Once a contract exists, it must be carefully administered to ensure it is not inadvertently modified or rights under the contract waived. Applying these principles will go a long way toward avoiding litigation to determine whether a contract exists, and if it does, its meaning and effect.

Employing a master services agreement often assists in managing these issues. For example, it could address the oil field “work order” situation by making it clear that a field employee signing an acknowledgment of delivery is not modifying a carefully drafted indemnity.

\(^{175}\) *Restatement (Second) of Contracts* § 214 (1981).

Recent case law reminds us, however, that even the carefully drafted master services agreement will not avoid all litigation. They can, however, make it less frequent and less painful.

\[E.g.,\] Industrial Project Solutions, Inc. v. Frac Tech Services, LTD, No. CV-12-BE-3806-S, 2013 WL 444350 (N.D. Ala. Jan. 31, 2013) (effect of master services agreement on contracts entered into by the parties before executing the master services agreement).
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Introduction

• **Basic premise of American contract law:** the parties can order their affairs as they see fit, with minimal judicial or legislative intervention.

• **Freedom of contract** is an opportunity; the goal is to make full use of the opportunity.

• **Control** the contract formation process.
Introduction

• Identify, and then use, the governing contract law principles.
• Opportunity to create the facts that courts will later use to define the parties’ rights and obligations.
• Must begin, however, with the correct body of governing principles.

Which Body of Contract Law?

• Goods, Services, and People.
• A diverse body of contract law applies to these subjects.
• Must select the correct body of contract law because it can differ in significant ways.
Which Body of Contract Law?

• First Level of Analysis
• Transactions in tangible personal property.
• Sale of goods.
• Lease of goods.
• Governed by Articles 2 & 2A of the Uniform Commercial Code.

Which Body of Contract Law?

• First Level of Analysis
• Transactions in other property.
• Non-goods transactions.
• Services.
• Intangible personal property.
• Real property.
• Governed by “general contract law.”
Which Body of Contract Law?

• An object lesson on why it matters.
• 1997 ABBS would build a pipeline and supply gas to Bluefield.
• Bluefield would pay ABBS, in addition to the gas price, a “reservation charge.”

Which Body of Contract Law?

• Contract provided the reservation charge would be reduced when ABBS recovered its pipeline construction costs.
• Payout occurred in October 2002.
• ABBS continued to collect the charge.
• December 2009 Bluefield sued ABBS.
• ABBS: statute of limitations defense.
Which Body of Contract Law?

- Sale of goods? 4-year SOL.
- Non-goods transaction? 10-year SOL.
- October 2002 to December 2009.
- Have you ever focused on the fact that "statute of limitations" is abbreviated: SOL?
- This is a mixed contract: sale of goods (gas) and non-goods (build pipeline).

Which Body of Contract Law?

Predominant Purpose Test:
- Is the contract primarily a sale of goods with incidental services being provided?
- Is the contract primarily providing a service with an incidental sale of goods?
- Held: primarily a sale of goods (supply gas) with construction of the pipeline incidental to the sale.
Which Body of Contract Law?

- **Therefore**: contract governed by Article 2 of the UCC, and the 4-year statute of limitations applies.
- **Therefore**: Bluefield is SOL.

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Which Body of Contract Law?

- **Sale of Goods**
  - Governed by UCC Article 2.
  - Generally, movable tangible personal property. UCC § 2-105(1).
  - Oil and gas to be severed by the seller. UCC § 2-107.
  - Many unique legal principles that differ from "general contract law" principles.
Which Body of Contract Law?

• **Lease of Goods**
- Governed by UCC Article 2A.
- *E.g.*, equipment such as compressors.
- Same sort of unique legal principles as found in UCC Article 2.
- For example, statute of limitations, statute of frauds, consideration, mutual assent, remedies.

Which Body of Contract Law?

• **Non-goods: Services.**
- Transportation, compression, processing of production.
- Drilling, completing, logging, fracing, and other well services.
Which Body of Contract Law?

• The issue is often whether the transaction is a *lease* of equipment, including the personnel to operate the equipment, or a contract to hire an independent contractor to provide a *service*.


Which Body of Contract Law?

• The issue in *Belger*:

• Did Holland Construction *lease* the crane, and the operator and oiler employees, from Belger?

• Did Holland Construction hire Belger to provide crane *services*?

• To what extent can terms on the back of a “work order” influence the facts?
Which Body of Contract Law?

• Court holds the crane was leased, but not the employees – and Belger owed an implied warranty to Holland that the crane was in safe working order.

Which Body of Contract Law?

• Another common sales/service inquiry:
  • Is the gas being sold in return for a share of the residue gas and liquids?
  • If so, UCC Article 2 applies.
  • Or, is the processor retaining a share of the residue gas and liquids as a service fee?
  • If so, general contract law applies.
Which Body of Contract Law?

- **Second Level of Analysis**
- Is the subject matter governed by a specialized body of contract law?
- "Consumer" transactions.
- "Construction" contracts.
- The broadest of anti-indemnity provisions.

Which Body of Contract Law?

- **Second Level of Analysis**
- Does the law of California, Idaho, Montana, North Dakota, Oklahoma, or South Dakota apply?
- If so, meet David Dudley Field II.
Which Body of Contract Law?

- He can ruin your day if you fail to account for how his "Field Codes" have modified the "general contract law" (and other law) of certain states.
- The classic "rabbit-out-of-the-hat" moment, all because somebody found *the statute*.
Contract Formation Issues

- Easy to create a contract.
- Objective theory of contracts.
- Freedom of contract creates burdens and opportunities.
- Control the contract formation process through drafting.

Contract Formation Issues

- **The Basic Task/Goal:**
- Be able to identify the parties’ contractual status at all times.
Contract Formation Issues

• Preliminary Negotiations

• Has a power of acceptance been created?
  – Is there an “offer” pending?

• Has a power of acceptance been exercised?
  – Has an offer been “accepted?”

Contract Formation Issues

• Until there is a power of acceptance that has been exercised, the parties are engaged in preliminary negotiations.

• At the preliminary negotiations stage, either party generally has the ability to walk away from the deal without liability.
Controlling Creation of a Power of Acceptance

PRELIMINARY NEGOTIATIONS ONLY. This correspondence does not create any sort of offer or power of acceptance. Instead, the statements made in this letter merely constitute preliminary negotiations.

Controlling Creation of a Power of Acceptance

• The Letter of Intent
  • The “intent” of the letter is typically to enter into a contract—*if* the parties can come to an agreement on all the essential terms.
  • States what the parties have tentatively agreed upon, and what remains to be agreed upon.
  • Can contain language indicating a present contract is intended, or perhaps an interim contract to “negotiate,” or no contract.
Controlling Creation of a Power of Acceptance

- Davis seeking financing.
- "[T]he parties understand and agree that the transactions contemplated by this letter are non-binding and subject to the following . . . ."
- "The parties agree to continue to work together on a best efforts basis to arrange for the completion of the financing . . . ."

"Upon receipt of an acceptable financing commitment, . . . [Davis and ACT] shall enter into definitive agreements to reflect the terms outlined in the Letter of Intent."

- "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Restatement (2d) of Contracts § 205.
Controlling Creation of a Power of Acceptance

- Have the parties entered into a contract to negotiate to try and arrive at a deal on the matter that brought them together?

PRELIMINARY NEGOTIATIONS ONLY. This correspondence does not create any sort of offer or power of acceptance. Instead, the statements made in this letter merely constitute preliminary negotiations. Either party can terminate negotiations at any time, for any reason, or no reason, without any obligation to the other party.
Controlling Creation of a Power of Acceptance

- **Reliance claims**: I relied to my detriment on your representations during our preliminary negotiations; my reliance was foreseeable and reasonable so pay me damages.
- Consider *Restatement (2d) of Contracts* §90:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.
Controlling Creation of a Power of Acceptance

• The Reliance Problem


Controlling Creation of a Power of Acceptance

• The Reliance Problem

Controlling Creation of a Power of Acceptance

PRELIMINARY NEGOTIATIONS ONLY. . . .
Any expenditure of money, time, personnel, or other loss of value, associated with conducting negotiations, will be the sole responsibility of the party suffering the expenditure or loss. Under no circumstances will it be reasonable for either party to take any action in reliance on anything said, not said, represented, or otherwise revealed or discussed during these negotiations.

More Formal Agreement?

• Formal Agreement Contemplated?
• Was preparation of the subsequent writing an obligation under an existing contract or was it intended to be the consummate act of mutual assent when prepared and signed by the parties?
• Manage by providing the facts necessary to answer the basic question.
More Formal Agreement?

PRESENT AGREEMENT INTENDED. Upon acceptance of this offer, the parties intend to create a presently binding contract which includes the obligation to have this contract memorialized in a formal written document acceptable in form to both parties and their legal counsel.

More Formal Agreement?

NO PRESENT AGREEMENT INTENDED. The agreements contained in this letter are merely the parties' preliminary negotiations and no obligations will arise between them until, and unless, they give their mutual assent by signing a formal written farmout agreement to be prepared by the proposed farmor.
Controlling *Exercise* of a Power of Acceptance

- **Managing the Offer:**
  - Lapse: How long will it last?
  - Reasonable Time vs. Specified Time
  - Revocation: Any limitations on offeror's ability to revoke the offer?
  - When does the revocation take effect?

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This offer lapses on May 31, 2013 at 5:00 p.m. local Topeka, Kansas time. However, Pierce can revoke or modify this offer any time prior to its acceptance. Any revocation of this offer will be effective when Pierce mails or otherwise dispatches notice the offer is revoked. The revocation will be effective when properly dispatched even though it is not received by Acme.
Controlling Exercise of a Power of Acceptance

- **Acceptance**: The offeror can prescribe exactly what must be done to accept the offer.
- Alter the mailbox rule to make it effective only if received by the offeror.
- **Acceptance by conduct**: The revocable license and excessive surface use. *Russell v. Texas Company*, 238 F.2d 636 (9th Cir. 1956).

Controlling Exercise of a Power of Acceptance

- **Soliciting the Offer**: 
- **Management Approval Clause**.
- Nail down the specific moment when an offer becomes a contract.
- *Manchester Pipeline Corp. v. Peoples Natural Gas Co.*, 862 F.2d 1439 (10th Cir. 1988) (sending the unsigned contracts to the producer was the "offer" and the producer signing was the "acceptance").
Controlling *Exercise* of a Power of Acceptance

- **Rejection:**
  - Is it a *rejection* that terminates the power of acceptance, or merely an *inquiry* that keeps the offer open while a parallel series of negotiations are pursued?
  - Did the offeror renew the offer after the rejection? "Think it over."

Controlling *Exercise* of a Power of Acceptance

- **Counter-Offer:** Parallel negotiation or a direct response to the offer?
  - *Smith v. Des Marteau*, 199 P.2d 1006 (Colo. 1948) ($1600 vs. $1600 "net").
  - So close, but yet so far.
Controlling the Terms of Offer and Acceptance

• **Battle of the Forms**
  - UCC Article 2 modifies the "mirror image rule" that an acceptance varying the terms of an offer is a rejection and counter-offer.
  - Under general contract law, performance following the "last shot" (last un-rejected offer), is acceptance on the terms of the last un-rejected offer.

Controlling the Terms of Offer and Acceptance

• **UCC § 2-207** designed to address the situation where parties exchange form documents that contain varying terms, followed by performance as though the parties have an agreement.
UCC § 2-207(1)

A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

Controlling the Terms of Offer and Acceptance

- Do the terms the parties chose to focus on in their negotiations agree?
- If so, an “expression of acceptance” has been made.
- How do we sort through the “additional” and “different” terms to define the contract?
The *additional terms* are to be construed as *proposals* for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
UCC § 2-207

• But, what about the “different” terms?
• “Drop out” rule: the different terms in the acceptance merely drop out, and you end up with a deal on the offeror’s terms.
• “Knock out” rule: the different terms in the acceptance do not become part of the deal, but they negate (knock out) the offeror’s different terms.

UCC § 2-207(3)

Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.
UCC § 2-207(3)

• Addresses situations where there is no "expression of acceptance" on the basic deal, but the parties proceed as though they have a contract.

• Can also arise where a party uses a defensive clause to prevent the operation of § 2-207(1) (acceptance expressly conditional on assent) or § 2-207(2)(a) (offer expressly limits acceptance).

UCC § 2-207(3)

• When this third subsection is triggered, the offeree is effectively able to cancel out the offeror's terms much the same way as does the "knock out" rule under § (2).

• The offeree, by proposing terms that prevent the writings of the parties from "agreeing," negates not only the offeree's terms, but also those of the offeror.
UCC § 2-207

• Although commonly viewed in the context of a battle of the “forms,” the analysis is not limited to “form” documents but applies to any actions between the parties that give rise to contract-formation issues.

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UCC § 2-207

• If either party finds these situations unacceptable, they must be prepared to police the documents they receive to ensure either: (1) unacceptable offers or “acceptances” are rejected, and the contracting process restarted until there is true agreement; or (2) performance follows the issuance of your new offer.

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Consideration Issues

- In the oil and gas context, consideration issues arise in two general situations:
  - (1) the *illusory agreement* where one party is obligated to do something and the other party has not limited their freedom to act in any real manner; and
  - (2) *modifications* to an existing contract.

Consideration Issues

- Many clients often seek ways to keep the other party on the hook while they retain unfettered freedom whether to perform an agreement.
- The problem is that when it matters, if the client is not bound, neither is the other party.
Consideration Issues

• Instead of going through the tortured process of trying to manufacture an obligation when none exists, clients should consider the device designed to allow them to think it over while the other party is locked into an offer: the option contract.

• One of the more under-used contracting tools.

UCC § 2-205

• An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months . . . .
Consideration Issues

• **Modification**
• The "work order," "work ticket," "delivery receipt," etc.
• **Two issues:**
  • *Authority* to alter existing contract terms.
  • *Consideration* for the alteration.

Consideration Issues

• The modification issue re-triggers all the basic contract formation issues, including mutual assent, consideration, and defenses to defective bargaining, such as mistake and unconscionability.
Consideration Issues

  - Holland's foreman ordered a crane from Belger's dispatcher, apparently over the telephone.
  - Several days later the dispatcher filled out a "work order form" which was taken by the crane operator to the work site.

• The precise procedure used to sign the work order was in dispute, but apparently it was signed by Holland's foreman.
• The reverse side of the work order contained ten paragraphs of "small print . . . attempting to establish the rights and obligation between the parties with respect to the use of the crane."
Consideration Issues

• "The work order form signed by plaintiff's dispatcher and defendant's foreman was just that[,] an order for the lease of equipment at a certain time and an acknowledgement of the receipt of the equipment."

• The court held the terms on the back of the work order had no effect on the parties' legal relations.

Consideration Issues

• "There was no evidence that the clauses were discussed or that Holland had actual knowledge thereof."

• This appears to be a mutual assent analysis: the parties agreed to a contract with terms A, B, and C, but not a contract with terms D through Z that were written on the back of the work order.
Consideration Issues

- An alternative analysis could find that an oral contract was made by the parties when they first agreed upon the services to be provided, the price, and the date, place, and time of performance.
- When the new work order terms were presented at the job site, this was a request for a modification of the existing oral contract.

Consideration Issues

- At common law the agreement to forego a contractual right required consideration to be enforceable.
- The Restatement (Second) of Contracts §89 has eliminated the requirement "if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made . . . ."
Consideration Issues

• If the contract concerns a sale of goods, UCC § 2-209 provides: "An agreement modifying a contract within this Article needs no consideration to be binding."

• However, the comment to 2-209 states it applies only to a modification made in "good faith."

Waivers

• Allowing client to see and hear another person's presentation on a prospect.

• The $4 Million "Waiver Agreement"


• Jury verdict on claims of negligence, gross negligence, fraud, and misappropriation of trade secrets.
Waivers

• $1.4 Million in Actual Damages—there might be oil out there.
• $2.6 Million in Punitive Damages.
• Successful bidder (no other bidders) on state leases. Unocal very active in area.
• Reversed by Court of Appeals.
• Signing letter waived any right to a claim for use of the information.

Statute of Frauds

• To properly resolve statute of frauds issues, the subject matter of the contract must be properly classified to ensure the appropriate body of contract law is being applied.
• U.C.C. § 2-201 (1977) (writing when price of $500 or more).
• U.C.C. § 2A-207 (1987) (writing when total amount is $1,000 or more).
Statute of Frauds

- Often no writing will be required if the contract can be performed within one year from the date it is made.
- Section 5 of the English Statute of Frauds.
- Writing required. Section 4 of the English Statute of Frauds.

Statute of Frauds

[N]o action shall be brought . . . upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them . . . unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized.
Statute of Frauds

- Documents signed but do not reflect an agreement.
- Documents signed that reflect an agreement, but too indefinite to enforce.
- No signed document sufficient to bind the targeted party.

Statute of Frauds

- "I'm sure they signed my proposal."
- Related to the statue of frauds is the obligation of the party asserting rights under a contract to establish its terms.
What Does it All *Mean*?

- **Parol Evidence Rule** used to identify the *contract terms*.
- **Interpretation Rules** used to determine what the contract terms *mean*.
- **Tortured Jurisprudence**: can anyone look at a word on paper and know what it means without considering extrinsic evidence? **Professor Corbin**: *No*.

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Conclusions

- Using this presentation, professionals who draft and administer contracts should be able to evaluate the contract formation practices of their clients and employers to identify those that may need attention.
- The goal is simple: be able to clearly and definitively ascertain, at any moment in time, the status of all parties throughout the contract formation process.
Conclusions

• Must know the precise collection of laws that apply to the proposed transaction.
• Once a contract exists, it must be carefully administered to ensure it is not inadvertently modified or rights under the contract waived.

Conclusions

• Employing a master services agreement often assists in managing these issues.
• For example, it could address the oil field "work order" situation by making it clear that a field employee signing an acknowledgment of delivery is not modifying a carefully drafted indemnity.
Conclusions

• Recent case law reminds us, however, that even the carefully drafted master services agreement will not avoid all litigation.