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6 Essential Elements of a Contract

From offer to legality, learn the six essential elements of a contract to make sure your agreement is valid and enforceable.



At the heart of most professional relationships is a contract. If you're striking a bargain, coming to an agreement, or closing a deal, a contract is what cements the obligations, rights, and duties of all parties involved.

And even though contracts are infinitely varied in length, terms, and complexity, all contracts must contain these six essential elements.

- Offer
- Acceptance
- Awareness
- Consideration

- Capacity
- Legality

When these six elements of a contract are present, it evolves from a simple agreement to a binding legal document. But if you lack just one of them, a contract may not be enforceable at all. It's helpful to have digital contracting software that manages all the elements of a contract for you.

Let's take a look at each element.

Contractual Offer

All contracts start with *desire* and *responsibility*. Someone wants (desires) something, and someone can fulfill (take responsibility for) that want. Known as "the offer," this first essential element encompasses the duties and responsibilities of each party, but must also demonstrate an exchange of value. That value can be money, or it can relate to a desired action or outcome.

Technically, an offer does not exist until it is received by the requesting party (the offeree). After the offer has been received, it can still be revoked, altered, or terminated at any time before acceptance.

The offeree is also free to extend a counter-offer. When a counter-offer is made, the original offer is terminated, and the parties are now in the process of bargaining for a new desired outcome.

Contract Acceptance

Once the offer is presented, the offeree can decide whether to accept or reject the proposal. The offeree can communicate acceptance either verbally or in writing (including mail or email)*.

Acceptance can take many forms, including:

- Conditional Acceptance
- Acceptance by Action
- Option Agreement

In general, a counter-offer is considered a termination of the original offer, but some circumstances allow for conditional acceptance. For example, the Uniform Commercial Code (UCC) acknowledges the validity of new conditions to an offer, as long as those conditions are made known to both parties and do not cause surprise or hardship.

Inaction is not considered acceptance for the purposes of a contract. This goes back to a legal tenant established in 19th Century Britain. In that contract case, a man offering to buy a horse declared that he would consider the horse purchased unless he heard otherwise from the seller. The court determined that assumption cannot create a contract. Acceptance must be explicit; merely taking action on one side (for example, shipping unsolicited materials) is not enough. Both sides must act, but if the actions are explicit and declarative, they will rise to the level of acceptance for the purposes of the contract.

**In most states, an offer is considered accepted once it has been placed in a mailbox. The "mailbox rule" applies even if the acceptance is never received by the offeror. The main rule of validity for an acceptance is that it must be a clear and direct statement that all terms and responsibilities in the contract are accepted.*

Signatory Awareness

Awareness is one of the elements of a contract because in order for a contract to be binding, both parties must first be aware that they are entering into an agreement. Often called "a meeting of the minds," both parties to a contract must be active participants. They must recognize the contract exists and are freely agreeing to be bound by that document's obligations.

In fact, contracts can be voided if awareness is not adequately established. For example, if one of the parties signed an agreement under duress or can prove undue influence, fraud, or misrepresentation, the contract will be invalidated. As a result, it is crucial for all parties entering into a contract to clearly and decisively establish that the agreement is genuine, mutual, and all parties consent to its contents.

In short, it's crucial that both parties know what they're getting into.

Contractual Consideration

In contract law, consideration is something of value that is exchanged between the parties to a contract. Consideration is essential for a contract to be valid and enforceable, which is why it's one of the key elements of a contract.

There are two types of consideration:

- Executed consideration: Executed consideration is something that has already been performed. For example, if someone agrees to buy a car for a certain price, the payment, the payment is executed consideration.
- Executory consideration: Executory consideration is something that is promised to be performed in the future. For example, if someone agrees to fix a car for an estimated price, the fixing of the car is executory consideration.

Consideration doesn't have to be monetary. It can be anything of value, such as goods, services, or promises. However, consideration must be something that both parties bargained for. For example, an offer to give something away for free doesn't count as consideration, because there's no bargain for anything in return.

Consideration must also be sufficient. This means that it must be something of value, but it does not have to be equal in value.

Contractual Capacity

In simplest terms, an individual cannot sign away their rights. Of course, the reality is a bit more complicated, which is why contract law requires that all signatories demonstrate that they clearly understand the obligations, terms, and consequences of the contract before they sign.

The court defines that understanding as "legal capacity," and each party signing a contract must demonstrate this legal capacity for the contract to be valid.

Generally speaking, people who fall into one or more of these categories may not have legal capacity to validate a contract:

- Minors
- Someone with a brain disorder (e.g., dementia)
- Someone under the influence of drugs or alcohol
- Someone without sufficient understanding of the language used in the contract

There are, of course, ways to overcome these capacity hurdles. A minor may have a court-appointed representative, for example. In the case of a foreign language, a translated copy of the contract could suffice. The final determination on capacity ultimately rests on understanding: does each party fully comprehend the contract's words and meaning?

Contract Legality

Finally, legality is one of the elements of a contract. All contracts are subject to the laws of the jurisdiction in which they operate, including any applicable federal, state, and local laws and ordinances. Obviously, a contract for an illegal action or product cannot be enforced. Even if the parties initially had no knowledge, if their agreement runs afoul of local laws, that lack of awareness is insufficient to overcome the legality burden. It also goes without saying that a contract that involves criminal activity is not valid.

As always, there are nuances. In general, the contract must adhere to the law in the jurisdiction where it's signed. Sometimes state and federal laws are not in alignment, and

in those cases, the Contract Clause (Article I, Section 10, Clause 1 of the United States Constitution) will be the guiding authority.

In addition, there are certain instances where a contract is no longer legal, including:

- Undue influence, duress, misrepresentation. When any party to the contract signs as a result of coercion, threats, false statements, or improper persuasion.
- Unconscionability. When the result of a contract triggers oppressive obligations or produces results that “shock the conscience of the court.”
- Public policy and illegality. When a contract violates public policy or jeopardizes public welfare
- Mistake. When an error in the contract has a “material effect” upon the obligations and responsibilities initially agreed to
- Force majeure. When circumstances beyond the control of the parties make it impossible to satisfy the obligations of the contract

Important Things to Know About the Elements of a Contract

Understanding the elements of a contract is crucial when entering into any legally binding agreement. A contract is a legally enforceable promise or agreement between two or more parties, and it typically consists of the essential elements mentioned above. Here are some additional considerations:

Intention to Create Legal Relations

For a contract to be valid, both parties must intend for it to have legal consequences. Contracts are generally not formed in social or domestic contexts where parties do not intend for legal enforcement.

Certainty and Possibility of Performance

The terms of the contract must be clear and specific enough for the parties to understand their obligations. Additionally, it must be possible to perform the contract’s terms. Contracts that are too vague or impossible to perform may be unenforceable.

Legal Formalities

While many contracts do not require any specific formalities, some contracts must be in writing to be enforceable, as per the Statute of Frauds. This typically includes contracts for the sale of real estate, contracts that cannot be performed within one year, and certain agreements involving the sale of goods over a certain value.

Time Frame

Some contracts specify a timeframe within which the obligations must be performed. Understanding and adhering to these timeframes is crucial for contract performance.

Performance and Discharge

Parties must fulfill their obligations under the contract, and once this is done, the contract is considered discharged, meaning that the parties' obligations are complete.

Breach and Remedies

If one party fails to perform as required by the contract (breach), the other party may have legal remedies available, such as the right to damages or specific performance.

Understanding the elements of a contract and their implications is essential for anyone entering into a contract. Consulting with legal professionals when dealing with complex or high-value contracts is often advisable to ensure that the contract is legally sound and to protect your interests.

Common Mistakes Made

When it comes to contracts, there are several common mistakes that individuals and businesses make in relation to the essential elements of a contract. These mistakes can lead to disputes, unenforceable agreements, or unintended consequences. Here are some of the most common errors:

- **Lack of clarity.** Failing to clearly and precisely define the terms and obligations in the contract is a common mistake. Vague language or ambiguous terms can lead to disputes about what the parties actually agreed upon.
- **Oral contracts.** Depending on the jurisdiction and the nature of the contract, oral agreements may not be legally enforceable for certain types of contracts (e.g., real estate or contracts that cannot be performed within a year). Failing to put important agreements in writing can be a significant mistake.
- **Failure to include essential terms.** Leaving out critical terms or elements required for a valid contract can render the contract unenforceable. For example, failing to specify the price or payment terms in a contract for goods or services.
- **Lack of consideration.** Forgetting to include an exchange of something of value (consideration) is a common mistake. Without consideration, a contract may not be binding.

- **Illegal or unenforceable terms.** Including terms in a contract that are illegal or against public policy can render the entire contract unenforceable. It's important to ensure that the purpose and terms of the contract comply with the law.
- **Impossibility of performance.** Failing to consider whether the contract's performance is possible or practical can lead to disputes. Contracts that are impossible to perform may be void.
- **Failure to identify parties properly.** Not accurately identifying the parties involved or failing to include authorized representatives can lead to disputes regarding the parties' obligations and responsibilities.
- **Inadequate details for performance.** Contracts that lack specific details on how and when obligations will be performed can lead to misunderstandings and disagreements about expectations.
- **Lack of review.** Failing to review contracts thoroughly before signing can be a costly mistake. Parties may inadvertently agree to terms they did not intend or overlook unfavorable provisions.
- **Failure to seek legal counsel.** In complex contracts or high-stakes agreements, not seeking legal advice can be a major mistake. Legal professionals can help identify potential issues and ensure the contract is legally sound.

- **Misunderstanding terms.** Parties may enter into contracts without fully understanding the legal consequences or obligations they are undertaking. It's important to seek clarification on any terms or language that are unclear.
- **Pressure or duress.** Entering into a contract under pressure, duress, or undue influence can render the contract voidable. It's important to ensure that both parties enter into the contract willingly and without coercion.
- **Failure to keep records.** Failing to maintain records of communications, changes, and amendments related to the contract can lead to disputes and difficulties in enforcing the contract.

To avoid these common mistakes, it's advisable to work with legal professionals, such as attorneys or contract specialists, when drafting, reviewing, or entering into significant contracts. They can help ensure that the contract complies with the law, accurately reflects the parties' intentions, and protects the interests of all parties involved.

How to prevent errors with the elements of a contract

Contract Lifecycle Management (CLM) software can be a valuable tool for helping organizations avoid many of the common mistakes associated with contracts. CLM systems are designed to streamline the entire lifecycle of a contract, from creation and negotiation to execution, management, and renewal. Here's how CLM software can help prevent contract-related mistakes:

Standardized templates. CLM software often provides standardized contract templates that include essential terms and clauses. These templates can help ensure that contracts start with a strong foundation and contain all necessary elements.

Automated workflows. CLM systems can automate the contract approval process, ensuring that contracts are reviewed by the appropriate individuals or departments. This helps prevent contracts from being signed without proper authorization.

Version control. CLM software maintains a record of all contract versions and revisions, making it easy to track changes and ensure that the latest version of the contract is in use. This reduces the risk of relying on outdated or incorrect contract terms.

Compliance checks. Many CLM systems have compliance features that check contracts against legal and regulatory requirements, helping to identify potential legal issues or non-compliance before the contract is finalized.

Alerts and reminders. CLM software can send automated alerts and reminders for important contract dates and milestones, such as renewal dates, performance deadlines, or termination notices. This helps prevent missed deadlines and contract breaches.

Document repository. A centralized repository in CLM software stores all contract-related documents and communications, making it easy to retrieve and reference contract information. This reduces the risk of losing critical contract details.

Collaboration tools. CLM systems often include collaboration features that enable real-time communication and negotiation between parties. This helps ensure that all parties are on the same page and can clarify any ambiguities in the contract.

Audit trails. CLM software maintains a detailed audit trail of all activities related to the contract, including who made changes, when they were made, and who approved them. This transparency helps prevent unauthorized alterations to contracts.

Reporting and analytics. CLM systems can generate reports and analytics on contract performance, compliance, and key metrics. This data can be used to identify trends, evaluate contract performance, and make informed decisions.

Integration with other systems. CLM software can integrate with other systems, such as procurement, accounting, and customer relationship management (CRM) systems, to ensure seamless data flow and coordination between departments.

Comprehensive search. Advanced search capabilities in CLM software allow users to quickly locate specific contract terms or clauses, making it easier to review and enforce contract terms.

While CLM software can be a powerful tool for avoiding contract-related mistakes, it is essential to complement its use with legal expertise and a well-defined contract management process. Legal professionals can provide guidance on complex legal issues and ensure that contracts meet legal requirements. Additionally, companies should establish clear contract management policies and provide training to employees responsible for managing contracts.