What You Thought Was a Deal Might Not Be:
What Every Business Should Know About Oral Contracts.

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As any business owner knows, oral contracts occur frequently in everyday business situations. A handshake and promise made to you by the contractor that you called in for a quick repair job could obligate you to pay that contractor even though there is no written contract stating that you must do so. Similarly, when an employee phones in an order to a supplier, that employee may be obligating his or her company to pay the supplier despite the fact there was no written contract. On the other hand, depending on the value of what the employee orders, the oral contract the employee thought he or she had may not be enforceable. The legality of oral contracts can be confusing. Oftentimes companies do not realize the implications of not putting their agreements in writing until it is too late.

Oral contracts are formed when two or more persons make mutual promises to do or not do something in exchange for something. Generally, where all the basic formation elements are met, an oral contract will be just as enforceable as a written one. The basic elements of any contract, including oral contracts are:

- Mutual intent to enter a contract (not one in the future, such as an agreement to agree sometime later, but one right now);
- A promise to give up something in exchange for inducing the other party to enter the contract (consideration);
- Capacity to contract (you have to be over 18, competent, and sane); and
- A legal subject matter (a contract in violation of law will not be enforceable).

Although the foregoing elements make forming a contract sound simple, the reality of oral contracts is frequently more difficult. Oral contracts cause no problems as long as the parties are happy and the terms of the contracts are performed well. However, when a dispute arises, the existence, enforceability and terms of an oral contract may become difficult to prove. Memories of the parties can fade, parties can interpret their responsibilities differently, and terms that may have been unclear to begin with can become even more ambiguous. Because it is one party's word against another's, parties may often deny the existence of a contract.

The main problem with oral contracts is whether any contract existed at all, and if so, what were its terms. Take for example a recent case decided by a Washington appellate court in which a debtor defaulted on a loan and orally offered to pay his lender a lesser amount on the loan until he caught up. The debtor thought he had a deal with the lender, but the lender never accepted the debtor's offer. The court held that no contract had been formed because the parties had never formed a mutual intent to form a contract. Had the parties taken the time to execute a written contract, the written contract would have been clear evidence of the mutual intent required by the court to enforce the contract. While written contracts certainly are not always immune from dispute, they do provide a certain level of clarity and serve as concrete evidence that the parties intended to form a contract.

That is not to say that oral contracts are not enforceable. In another recent case, a buyer orally offered to purchase a TV business. The TV company called the buyer and orally accepted the buyer's offer on the phone. The next day, the TV company called the buyer back and retracted its acceptance. A court held that the parties had an enforceable oral contract based on evidence of the parties' conversations, offer and acceptance. The buyer was fortunate to have well-documented evidence of the parties' conversations leading up to the contract formation.

Such is not always the case in an everyday business situation where one employee informally attempts to make a contract with a supplier who then fails to perform his or her end of the bargain.

Oral contracts are unenforceable in certain situations. One such situation arises in the purchase and sale of "goods". Generally, under the Uniform Commercial Code, a contract for the sale of goods valued more than $500 is not enforceable unless it is in writing and signed by the person against whom you seek enforcement. With the exception of realty, virtually anything that is not a service can be a good. A plant is a good, as are plants not yet grown. Planting that plant or transporting that plant to a site, however, are services.

Thus, if you make an oral contract for the sale of goods worth $500 or more, that contract will not be enforceable unless it is in writing and signed by the person against whom you seek enforcement. An exception to this rule exists for specially manufactured goods that are not suitable for sale to others in the ordinary course of business where the seller of the goods has started to manufacture them before the buyer cancels the contract. Another exception exists where a business confirms the existence of an oral contract through a written document (often a fax confirmation or email) within a reasonable time after the contract is made. In such a situation, the oral contract will be enforceable against the business who sends the written confirmation.

As an example, assume someone orders $600 worth of fertilizer from you in a phone order and agrees to pay you for delivery on Tuesday. On Sunday, you as a retailer, pay a fertilizer supplier $525 for the fertilizer you promised to deliver to the buyer. On Monday, the buyer calls you up and cancels the order. You are out $525 in cost plus $75 in profit. Can you still make the buyer pay the $600 according to your oral contract? Unfortunately, the answer is

no. Although you had an oral contract with the buyer ordering the fertilizer, that contract would be unenforceable because the value of the fertilizer was over $500, which requires it to be in writing and signed by the buyer to be enforced against the buyer. As we so often advise our clients, it is better to make sure any contract for the sale of goods is in writing.

In addition to contracts for sales of goods worth $500 or more, some contracts simply must be in writing or they will be invalid. This rule derives from an old English term called the "Statute of Frauds". The idea behind the English Statute of Frauds and its modern version is that certain types of contracts that have certain economic or social importance must be in writing to prevent fraud. Examples of contracts that must be in writing and signed include: (1) contracts that cannot be performed within one year; (2) contracts to pay someone else's debt; (3) contracts that promise something upon someone's marriage; (4) every promise made by an executor or administrator to answer damages out of his own estate; (5) any contract authorizing or employing an agent or broker to sell or purchase real estate for compensation or a commission; and (6) all real estate contracts.

Given the frequency with which the law requires contracts to be in writing, we advise our clients to put any contract they may have in writing. The advantage of written contracts is that everything is laid out in terms that the parties have hopefully had the chance to negotiate. Written contracts also allow third parties to objectively verify that a contract existed where parties' memories may be lacking. That is not to say that oral contracts cannot be useful in certain situations, or that they are generally enforceable. But because the Statute of Frauds and the Uniform Commercial Code require many contracts to be in writing, and given the evidentiary problems with proving the existence or terms of oral contracts, businesses may wish to think twice before entering them. While it may take more time and increase the formality between

otherwise casual business relationships where a handshake normally suffices, even good business partners can disagree or have a falling out in the absence of a written contract.

Specific legal problems require specific legal advice. This article is intended to provide general information and should not be construed as legal advice.

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