**Option Contracts and Firm Offers**

Welcome to this podcast on Option Contracts and Firm Offers brought to you by CALI. I am Professor Jennifer S. Martin. An offer creates the power of acceptance in the offeree. The topic of this podcast is how to determine whether the offeror can terminate the offer or whether the offer is irrevocable.

Recall that a contract is a promise or set of promises which the law enforces. Ordinarily, the manifestation of mutual assent takes place by virtue of an offer by the offeror, which is then followed by an acceptance by the offeree. Typically, an offeror can revoke an offer freely at any time prior to acceptance, but at times an offer is irrevocable. An offer may be found to be irrevocable in the following four situations: (i) the formation of an option contract; (ii) the formation of an option contract when an offeree renders partial performance of an offer for a unilateral contract; (iii) a firm offer under UCC § 2-205; and (iv) by detrimental reliance. Let’s look at each of these in turn.

Let’s begin with traditional option contracts. An option contract is simply a contract (meaning there is mutual assent and consideration), in which the offeror agrees to limit the power to revoke the offer. The requirement of consideration here means that the offeree must provide some consideration to the offeror in order to make the offer irrevocable. The amount paid as consideration does not matter, so long as the contract is on fair terms. Let’s look at some examples.

Example #1. Teacher offers to give private piano lessons to Student for the fall semester for the fee of $500. There is no option contract here and the offer is fully revocable by Teacher at any time prior to acceptance.

Example #2. Teacher offers to give private piano lessons to Student for the fall semester for the fee of $500 and promises Student to keep the offer open for seven days. This would not be an option contract, and the offer would be revocable by Teacher because the promise to hold open the offer was not supported by consideration. Notice that here even though the offer expressly states that it will be held open, the offer is fully revocable in the absence of consideration given by the offeree.

Example #3. Teacher offers to give private piano lessons to Student for the fall semester for the fee of $500 and in exchange for Student’s payment of $10, Teacher promises Student to keep the offer open for seven days. This would be an option contract, and the offer would not be revocable by Teacher because it is supported by consideration, the promise of $10 in exchange for the promise to keep the offer open. However, many courts would find the offer revocable if the $10 consideration was not in fact paid by the offeree.

Let’s turn to the formation of option contracts by partial performance of an offer that can only be accepted by a return performance (sometimes called an offer for a unilateral contract). A classic illustration of a unilateral contract is where Martin says to José, if you find my lost dog Angus and return him to me, I will pay you $200. Martin, the offeror, does not want José to promise to locate Angus. Instead, Martin wants José to actually find Angus and return the lost dog. There is no promise expected of José in terms of his acceptance. Rather, José can only accept the offer by actually finding the dog and returning him.

In the case of an offer for a unilateral contract, an option contract is created when the offeree tenders or begins the performance requested by the offer, making the offer irrevocable. At this point, the offeree has the ability, but not the obligation, to complete the performance invited by the offeror. The offeror does not have to perform, though, unless the offeree completes the requested performance. Simply, this option contract makes the offer irrevocable once the offeree has begun performance of an offer for a unilateral contract.

How might this work? If José has already begun looking for the dog, an option contract arose when he began the performance of looking for the dog. As such, when Jose begins performance, Martin cannot revoke her offer. José has the ability to complete the requested performance of finding the dog and returning the dog to Martin in a reasonable time. However, the performance is at the option of José, meaning he does not have an obligation to actually find the dog and might abandon the performance prior to completion. If José finds the dog and returns the dog to Martin, then Martin will be obligated to pay him the $200. If José does not find the dog, then Martin’s obligation does not arise. Of course, José only has a reasonable amount of time to find the dog and return Angus to Martin.

You might wonder whether preparing to perform also creates an option contract in favor of the offeree. The general answer is no, there is a difference between preparing to perform and actually beginning the invited performance. Presume that José has not yet begun looking for Angus, but decides that the task would be better done after lunch. Preparing to perform by having lunch first would not create an option contract in favor of José. As such, Martin would be free to revoke her offer to José while he is eating lunch.

Let’s turn to firm offers under UCC § 2-205. Section 205 makes some offers for transactions in goods irrevocable. An offer by a merchant to buy or sell goods in a signed writing which gives assurances that it will be held open is irrevocable even if the offeree has not given consideration to hold the offer open. A merchant here meaning a person dealing in goods of the kind or otherwise has skills or knowledge peculiar to the practices or goods involved in the transaction. If no time is stated as to how long the offer is to be held open, a reasonable time applies, but no more than three months. Let’s look at an example.

Example #4. Seller, a sporting goods retailer, writes to Coach, offering to sell 25 new soccer balls printed with the team logo for $900 and promises that the offer will remain open for 30 days. This offer would be a firm offer under § 2-205 because it was made by a merchant, Seller, in a signed writing giving assurance that the offer to sell the soccer balls would be held open for 30 days. Let’s look at another example.

Example #5. Presume the same facts as Example #4, but Seller promises that the offer will remain open for four months. This offer would be a firm offer under § 2-205, but would be only irrevocable for 90 days in the absence of consideration given by the offeree.

Before turning to reliance, it is worth noting that other statutes may also make offers irrevocable. A common situation is found in construction bids for work to be done for a city, state or other governmental branch. Oftentimes local statutes indicate that in these situations the bids, which are offers, are irrevocable for a specified period of time. Even when a statute does not make these offers irrevocable, a court may find that public policy makes these types of offers irrevocable for a limited time. Let’s look at an example.

Example #6. Landscaper submits its bid for $100,000 to Southern City related to a request for bids for landscaping the public parks. Landscaper obtained other projects and decided it no longer wanted to pursue the Southern City project. If there is a statute, Landscaper’s offer may be irrevocable. In the absence of a statute, whether Landscaper’s offer would be irrevocable may depend on whether Southern City has opened the bids and relied.

Before concluding, let’s turn to detrimental reliance making an offer irrevocable. It is important to note that reliance typically turns on whether there would be injustice. As such, cases making an offer irrevocable because of reliance are rare. If an offeror makes an offer and should reasonably expect to induce some action or forbearance on the part of the offeree and does actually induce the action or forbearance, a court may find the offer irrevocable as an option contract. Let’s look at an example.

Example #7. Landlord leases an upstairs apartment at her beach home to Tenant. Landlord offers Tenant an option to buy the home for $500,000 within five years. With Landlord’s approval, Tenant makes permanent improvements to the beach home, including remodeling the kitchen. Landlord revokes the option and refuses to sell. A court might find an option contract here based upon the reliance of the Tenant, which would make the offer of Landlord irrevocable.

At this point, you should be able to identify the four common situations in which an offer will be irrevocable: the formation of an option contract; the formation of an option contract through part performance of an offer for a unilateral contract; a firm offer by statute, such as UCC § 2-205; and an option contract arising because of detrimental reliance. You should be able to evaluate factual situations to determine whether one of these situations will result in an irrevocable offer.

I hope you’ve enjoyed this podcast on Option Contracts and Firm Offers.

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