Subjective Theory vs. Objective Theory of Contracts

The objective theory of contracts holds that an agreement between parties is legally binding if, in the opinion of a reasonable person who is not a party to the contract, an offer has been made and accepted.

This legal concept has become the standard for determining the intent of parties in an agreement since the late 19th century. The objective theory of contracts supersedes the previous standard, known as the subjective theory of contracts or "meeting of the minds," that was commonly applied throughout the early 1800s. Thus, the main determinant in the validity of a contract is the acts, or external performances of the parties, not the internal state of mind, or intent of the parties, that exists when coming to an agreement.

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There is some debate as to what constitutes a legally binding contract. Many legal scholars believe that the Common Law governing contracts has always, to some degree, required an objective test by an unbiased third party to determine the validity of an agreement. Some scholars argue that the objective theory is only a recent development and that precedent dictates that the long-held subjective theory should still be applied in the courts.

However, even these scholars, known as "subjectivists," recognize that by the late nineteenth century the other side, the "objectivists," had gained the upper hand, and the objective theory is the widely accepted theory.

Briefly, the major differences can be summarized by the following examples:

- Party A owns a guitar signed by Elvis Presley appraised as being worth several hundred thousand dollars. A neighbor, Party B, expresses interest in the guitar and in jest tells Party A that they'd pay a million dollars for the opportunity to own such a treasured keepsake. Party A agrees and challenges in court that an agreement was reached with the neighbor, even though he knows that the neighbor does not have access to that kind of money. The subjective theory holds that there was not a "meeting of the minds," and that neither party had an expectation of the transfer of the guitar occurring.
- In a similar scenario, the neighbor expresses interest in the guitar, and this time, Party A states a price for selling the guitar based on the appraisal rate and actually lets the neighbor get the instrument appraised by a third-party. The neighbor then sells valuable assets to raise the funds to purchase the guitar, but at the last minute the owner decides not to sell. Applying the objective theory, the court could determine that through the act of setting a price, letting an independent appraisal occur and the neighbor acting to raise the funds, a valid contract between the parties does exist.

What spurred the transition from the long-held concept of subjective theory to the popularity of the objective theory of contracts now being used in U.S. courts of law? Scholars agree that many prominent judges issued decisions in contract disputes applying the objective theory of contracts beginning sometime in the late-nineteenth century. These included U.S. Supreme Court judges and leading authorities on contract law, such as Christopher Columbus Langdell and Samuel Williston, who argued that it was difficult for one person to subjectively determine the thoughts of another and to, in effect, read a person's mind.

Not Always Black and White

Although both sides, the “subjectivists” and the “objectivists” appear to hold vastly different views on the way intent should be determined by a court of law, in many cases, both theories can justifiably be applied.

If two parties enter into an agreement through a clear and obvious “meeting of the minds” and also make external acts that show their intent to consummate an agreement, the contract could be deemed binding. However, both theories could also be used if one party was to argue there was no actual intent to form an agreement. It would come down to whether or not a “reasonable person” would consider that both parties were proceeding in good faith toward the agreement or whether or not the deal was too good to be true and to one party’s obvious advantage.