Contracts, Part II: The UCC

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The Uniform Commercial Code (abbreviated as UCC) is a law covering many aspects of business transactions. The UCC was written in 1949 in an effort to unify laws affecting business throughout the United States. By 1967, the UCC had been adopted with only minor changes by the legislatures of all the states, with the exception of Louisiana, which has not adopted Articles 2 or 2A. (Louisiana's law is still heavily influenced by French civil law and tends to differ in significant ways from those of the other 49 states.)

The UCC is divided into nine Articles, or sections, each of which covers a fundamental area of commercial law. For example, Article 2 deals with sales contracts, which we will discuss in this chapter.

10.1 Why the Uniform Commercial Code Is Important to Businesses

Can you imagine trying to conduct business in the United States if contract law differed from one state to another? The UCC ensures the uniformity and predictability of interstate commerce for companies that conduct business in more than one state. For example, if a seller in Nevada wishes to enter into a contract with a buyer in California, both parties can be reasonably certain that the law in their state is the same, because both states have adopted the UCC. As you read about the UCC rules and consider the impact they have on business transactions, remember that the UCC makes business transactions possible and predictable throughout the United States.

What Does Article 2 of the UCC Apply To?

Article 2 of the UCC deals with the sale of **goods**. Real estate, employment, insurance, and similar services are covered by the common law. To be considered goods, the **subject matter of the contract** must be movable and tangible, such as an automobile or a lawn mower. For the most part, whether something is a *good* is quite easy to determine, but there are exceptions. Consider electricity, for example. Do you think that is a good? Ask yourself whether it is movable and tangible. It moves through wires, and if you stuck your finger in a plug you would find it very tangible, so yes, it qualifies as a good that is subject to the UCC. Are animals, oil, and trees goods? The answer is that yes, animals are goods, but oil, gas, and trees are all goods only if they are removed from the land by the seller. They would be considered *nongoods* if removed by the buyer.

As discussed in Chapter 9, Contracts, Part I: Introduction and Formation, if a contract is a mixture of both goods and services, which law applies is determined by the *predominant test*. That test states that whichever element is greater in price or intent prevails. For example, if the cost of the goods is greater than the cost of services, the contract is covered by the UCC. If the services are worth more, then the contract is governed by the common law.

To Whom Does the UCC Apply?

One major area of confusion for students is to whom the UCC applies. Students are apt to think that it applies only to merchants, but that is not true. The UCC applies to everyone in the United States who buys and sells goods, whether he or she sells them at a garage sale or at the Mall of America. It's true that certain sections of the UCC apply only to merchants, but the vast majority of the law applies to merchants and nonmerchants alike. When there is a distinction, we will point it out throughout this chapter.

10.2 Acceptance Under the UCC

Recall that to form a valid contract, five elements must be satisfied: *offer, acceptance, consideration, capacity*, and *legality*. If the contract is for the sale of goods, those same five elements apply under the UCC, largely as they do under common law, with one exception: *acceptance*.

Under the common law, acceptance is covered by the *mirror image rule*, which requires all the elements of the acceptance to mirror all the elements of the offer. Thus, if the offer were for a $450,000 house with a 5% mortgage and the buyer responded that he or she will "take it, but with a 4% mortgage," that would not be a mirror image, and there would be no contract.

Under the UCC, the opposite rule applies; however, the explanation is somewhat involved. For the rule of **acceptance under the UCC**, the UCC does distinguish (depending on who the parties are) between merchants and nonmerchants. According to the UCC §2-104, a *merchant* is a party who "regularly deals in goods of that kind." Think of a car dealership, for example, to envision who is a merchant. On a daily basis (*regularly*), the dealership is selling cars (*goods*) and nothing else (so, *goods of that kind*). Contrast the car dealership with someone selling a car on Craigslist. The item is still a good, but the person selling is selling one car just this one time, and so is not a regular dealer. Further, if that person is selling a car, a vacuum cleaner, and some old paintings, he or she is still not dealing in *goods of that kind* but in many different kinds of goods; thus, that person is a **nonmerchant** under the UCC.

To further complicate matters, when it comes to the rule of acceptance, the UCC distinguishes between transactions by two merchants, two nonmerchants, and a merchant with a nonmerchant.

First, we will look at what is called the **rule of nonmerchants**, which actually means either a contract between a merchant and a nonmerchant or a contract between a nonmerchant and a nonmerchant.

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The Rule of Acceptance for Nonmerchants

For contracts between two nonmerchants, or between a merchant and a nonmerchant, the rule is this: if the offeree adds any new terms to the offer, the new terms become **proposals** to the contract, but the parties do have a contract for the terms they agreed upon.

Suppose that your business (a merchant, because it is commercial) sends an offer to a nonmerchant. The offer states that your business offers to sell to the buyer "10 crates of pineapples at $5.25 per pound" packed in green crates. The buyer responds, "Will take the pineapples at that price in green crates, but could you have them here by Monday?" You may be surprised to learn that, under the UCC, the parties have formed a contract for the terms they have agreed upon, namely, the quantity (10), the price ($5.25 per pound), and the green crates. When the buyer asked for a delivery time of Monday, that term became a *proposal* to the contract. Although the offeror can decide what to do with that term (accept it, reject it, or modify it), the parties do have a contract for the terms they agreed upon. See Table 10.1.

Table 10.1: Sample offer and acceptance between nonmerchants

OFFER	ACCEPTANCE	THE CONTRACT
Pineapple	Pineapple	Pineapple
$5.25 / lb.	$5.25 / lb.	$5.25 / lb.
Green crates	Green crates	Green crates
+ PROPOSAL		
Monday delivery		

Note from Table 10.1 that most of the terms of the offer and most of the terms of the acceptance in gray mirror each other. The terms that match form the contract. The term that doesn't match is the proposal. The parties have a contract for the subject matter in gray but not for the "Monday delivery," which is the term proposed by the buyer/offeree.

Why is this significant? In your negotiations as a businessperson with buyers, it is essential that you be aware that you could be forming a contract with a nonmerchant who accepts your offer but adds new terms. Under the UCC, that is no longer a negotiation but a contract, and you are bound to its terms. The way to avoid such contract formation is to use terms that make the contract conditional on certain events. You could use language like "On condition that . . ." or "Only if . . ." For example, you could say, "I will sell you ___ only if you agree to these terms," or "Take it or leave it" or "Without any changes to this offer." All of these phrases limit assent to a mirror image acceptance and make any changes into *counteroffers* rather than contracts.

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The Rule of Acceptance Between Two Merchants

When both parties are merchants, the stakes are raised even higher. Now any new terms in the acceptance automatically become part of the contract unless:

(1) The offeror objects to them;
(2) The offeror makes agreement conditional upon a mirror image acceptance; or
(3) The new terms materially alter the contract.

For example, in the contract above, if both parties had been *merchants*, then the Monday delivery would have automatically become part of the contract unless the offeror objected to the term. The offeror could have made the offer subject to the *mirror image rule* with words like "Take it or leave it."

It is interesting to note that most offerors do not make their offers subject to a mirror image acceptance, nor do they object to the new terms. In fact, in most cases that are litigated, none of the parties have read the other's response, and thus are unaware that new terms have been added to the contract.

Table 10.2 shows that, between two merchants, if the offeree adds any new terms to the acceptance, those new terms automatically become part of the contract, unless it falls under one of the exceptions.

Table 10.2: Sample offer and acceptance between merchants

OFFER	ACCEPTANCE	THE CONTRACT
Pineapple	Pineapple	Pineapple
$5.25 / lb.	$5.25 / lb.	$5.25 / lb.
Green crates	Green crates	Green crates
	Monday delivery	Monday delivery

How is this important in business? Suppose, for example, that the buyer and seller engaged in a written contract for a multimillion-dollar computer system. When the buyer accepted the offer, the buyer sent a written acceptance that added a warranty term of 10 years to the contract. The computer broke down after it was installed, and the seller was amazed to learn that the buyer had added a warranty in the acceptance, probably because the seller's employees had never bothered to read the acceptance.

Now the parties have found themselves in court. Since they are both merchants, the warranty automatically became part of the contract. The seller had never objected to the warranty term, nor had he or she made the acceptance conditional on a mirror image acceptance. The only other exception the seller could invoke is that the addition of the warranty was a significant economic change, but the court didn't agree that it was. Therefore, the warranty term became part of the contract and the seller had to honor it. This would certainly be a harsh lesson for the employees in charge of that firm's contract negotiations.

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10.3 Contract Terms and Conditions

Terms and conditions of a contract refer to the parts that make up the whole. Examples of terms are the price of the goods, when they will be delivered, the type of delivery carrier, how payment will be made, and how many units will arrive per shipment. Parties are free to, and should, negotiate all these aspects of their agreement. There are no rules for what price you have to charge or when you have to deliver goods. If the other party wants to pay you in gold coins and take delivery at three in the morning in Topeka, Kansas, wearing pink pajamas, and you agree to such terms, the law will honor your private, albeit eccentric, understanding. As long as it is constitutionally sound, private parties can and should craft their own contract terms.

Gap-Filling

Quite often, however, people put too little thought into contract formation and leave out important terms they should have negotiated. These contracts may end up in court when the parties sue one another to enforce what they thought was in their agreement. Under the UCC, if parties leave out a term, the court will fill it in: a process called **gap-filling**. For example, if a contract is concluded without agreeing on a price, the UCC provides that the price will be the going rate at the time the goods were delivered. This could have a significant impact if the price of the goods changes significantly between the time of making the contract and the time of delivery, which could be a few months. By the time the parties get to court to litigate the price, however, years could have gone by. Going to court, of course, also entails the parties hiring attorneys and spending thousands of dollars litigating a matter they could have agreed upon when they negotiated the contract in the first place. They do have an enforceable contract—it's just that no one is going to get paid under its terms for many years to come, and then only after expenses that may exceed the cost of the contract.

Table 10.3 illustrates several contract terms under the UCC and how the process of gap-filling would play out in court.

Table 10.3: Gap-filling under the UCC in courtroom situations

TERM LEFT OUT OF THE CONTRACT	GAP-FILLING UNDER THE UCC
Delivery	Unless otherwise agreed, all *goods* called for by a *contract for sale* must be tendered in a single delivery.
Place of delivery	Unless otherwise agreed: (a) The place for delivery of goods is the seller's place of business or, if none, the seller's residence.
Price	In such a case, the price is a reasonable price at the time for delivery if: (a) Nothing is said as to price; (b) The price is left to be agreed upon by the parties and they fail to agree.
Quantity	Court will not gap-fill this term; the contract will fail.

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The one term courts will not gap-fill is quantity. If the parties leave out quantity, the contract fails. There is one very important exception to this rule, however, called an *output-requirement contract*. Suppose that you work for a manufacturer and your employer asks you to negotiate a contract to purchase enough bolts for all the machines your company will manufacture in 2015. The first question you will ask is, "How many bolts should I order?" Unfortunately, it may be quite impossible to divine how many bolts they will need in the future. Therefore, the UCC allows a special type of contract to exist without a specific quantity, called an output-requirement contract. In these contracts, the buyer can order "All that I require in 2015" or "All that your company manufactures . . ." or "All that I need . . ." Underlying these contracts is the recognition that the contract must be carried out in *good faith*. For example, if the buyer becomes angry with the seller, the buyer cannot then order one bolt and protest, "But that was all I needed!" A look at the records for past years would show that the buyer usually ordered 10,000 or more per year, so "all that I need" would have to be closer to that number. The UCC describes a *reasonable quantity* in such a contract in this way: "no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded" (Uniform Commercial Code §2-306).

If there is one lesson to learn from judicial gap-filling, it is to spend sufficient time making sure that all of the terms are negotiated and written into the contract *before* goods are delivered. Otherwise, you may have a costly, time-consuming mistake to deal with.

Contract Modifications

Frequently, parties to a contract need to change the terms they agreed to initially when they formed the contract. **Contract modification** occurs *after* contract formation. The UCC altered the rules for modification by not requiring any new consideration to make the changes enforceable. Thus, no money has to be paid and no new work has to be carried out to make the changes enforceable. Consider the following example.

> ***A lawn and garden store agrees to sell a garden tractor to a buyer but needs to order it from the manufacturer. The price is $1,000, and it has a written contract for the sale. After contract formation, the price of gas doubles and the cost to deliver the tractor rises dramatically. The lawn and garden store approaches the buyer and explains the situation, and they reach an agreement that the lawn and garden store will now receive $1,100 for the same tractor. This is a change or modification to the original agreement. Notice that both parties agreed to the change, but they were under no obligation to do so. If this same contract were under the common law, a contract modification would be enforceable only if consideration was given for the modification.***

Writing Requirements

The **Statute of Frauds** governs **writing requirements**: which contracts must be *in writing* to be enforceable. Generally speaking, most contracts can be oral and still enforceable. The problem with an oral contract, of course, is proving that it even exists, and if so, what its terms are. However, if that problem can be overcome, then contract enforcement is possible.

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"In writing" doesn't mean that the contract is literally written down on a piece of paper; rather, it means that it must have enough information to *prove* it is a contract. That is, it must state what the consideration is and include the signature of the party to be charged (the party sought to be bound by the contract). The "signature of the party to be charged" sounds like the party who is paying, but it does not mean that at all; rather, the party to be charged (to be burdened) is quite simply the defendant. So, to be in writing, the contract needs the signature of the defendant. Consider the following example. Note that under the UCC, a contract for the sale of goods greater than $500 must be in writing to be enforceable.

> ***The seller, Bob, calls the prospective buyer and offers to sell his car for $3,400, to which the buyer agrees. The seller then e-mails the buyer, stating, "I am so glad you agreed to buy my car! Here is my address. Please send the check for $3,400 within five days. Signed, Bob."***

Is this contract in writing? The answer is no—it is oral. To be "in writing," the contract needs the signature of the defendant (in this case, the buyer) because it is Bob who wishes to enforce it. However, since the buyer never signed the contract, it is not in writing. If, however, the buyer wanted to sue the *seller*, the contract would be "in writing" because the seller signed his name, and thus, the *signature of the party to be charged* is present.

Exceptions to Writing Requirements

Several types of contracts for the sale of goods greater than $500 can be oral and still enforceable. One is of particular importance to the businessperson: an oral contract for the sale of goods greater than $500 that is subsequently followed up by a written confirmation. This is called the **merchant's confirming memorandum** exception. Consider the following example.

> ***A merchant seller calls a merchant buyer and says, "I have a good deal on fruit that just arrived from Florida. I have mangos in crates for $200 per crate, and I can get them to you by Thursday. Are you interested?" The buyer replies by telephone, "Yes, certainly. I'll take 300 crates."***

Notice that the contract is for goods worth well over $500, which should normally be in writing. But if one of the merchants (it doesn't matter which) sends the other a written confirmation of the conversation, then this conversation (an oral agreement) becomes an enforceable contract. Although the e-mail might not meet all the requirements of a written contract (for example, it might be missing the signature of the party to be charged), it is nevertheless enforceable, unless the party receiving it objects to it in a record (in tangible form) within 10 days of receipt.

Another oral contract for the sale of goods greater than $500 that can be enforceable is a contract for **specially manufactured goods**, which are custom made. The rationale behind this rule is that, normally, a seller would not buy raw goods to begin manufacture, nor start manufacture without a reasonable belief that a contract existed. So if a seller begins working on the goods but the buyer then refuses to buy them, and the seller cannot market them elsewhere, the UCC allows the seller to recover their costs, even if the contract was not in writing.

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Lastly, the UCC provides that if a contract was for more than $500 and *should* have been in writing, it will nonetheless be enforced if either payment has been made and accepted or the goods have been received and accepted. An example follows.

> ***The buyer and seller enter into a contract for the sale of an automobile for $35,000 but do not put their agreement in writing. The seller delivers the car to the buyer, and the buyer pays for the goods. Then, after driving around town with the car, the buyer thinks twice about the transaction. Now the buyer claims he or she wants his or her money back and that there was no contract because it should have been in writing. Under the UCC, however, it is too late to raise the Statute of Frauds as a defense to the contract.***

Key Terms

acceptance under the UCC If both parties are merchants, the offeree can give a non–*mirror image acceptance*, and all new terms became part of the contract. If the parties are nonmerchants, then any new terms in the acceptance become *proposals* to the contract.

Article 2 of the UCC The section of the Uniform Commercial Code that governs contract law for the sale of goods.

contract modification Changes to a contract after contract formation.

gap-filling The rule under the UCC that the court will fill in any term not agreed upon by the parties, other than definite quantity.

goods Items that are tangible and movable.

merchant's confirming memorandum A writing following an oral contract that confirms the agreement between merchants for the sale of goods worth more than $500, thereby making the contract enforceable.

nonmerchant A person who does not deal regularly in goods of that kind.

proposal An offer for consideration or acceptance.

rule of nonmerchants Either a contract between a merchant and a nonmerchant or a contract between two nonmerchants.

specially manufactured goods Goods that are custom-made.

Statute of Frauds The law governing which contracts have to be in writing to be enforceable, e.g., under UCC Article 2, those for goods worth more than $500.

subject matter of the contracts Goods or services the parties are selling in the contract.

terms and conditions Specific parts of the contract that detail the parties' agreement.

writing requirements The rules regarding what terms have to be in a contract for it to be considered "in writing." To be considered a contract, it must state what the consideration is and include the signature of the party to be charged.

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Critical Thinking and Discussion Questions

1. What does UCC stand for? What does the UCC apply to? To whom does the UCC apply?
2. What does "Article 2 of the UCC" govern?
3. How can you tell if a contract is governed by the UCC or the common law?
4. What is the significance of being governed by the UCC or the common law?
5. Your company sent a written offer to a nonmerchant, to which the nonmerchant added, "All terms are agreed to. In addition, I need the parts delivered by next Thursday." What is your obligation to deliver the parts by that date?
6. Assume in the situation above that both the parties are merchants. What is your obligation to deliver the parts by that date? What actions could you take to ensure that the buyer's additional terms do *not* become part of the contract?
7. You sent out a written offer to a seller to purchase 10 minivans, model #306945ZY, and concluded the contract negotiations except for the price of the goods. The seller accepted your contract and you put the agreement in writing. Because of fluctuations in transportation prices, however, you concluded the agreement without ever agreeing on a final price. You both decided that you would figure out a price later on when the transportation markets settled down.
   a. Do you still have a contract even if you never reach an agreement on the price?
   b. In the event that you go ahead with the contract, how will the price be set?
   c. Assuming you can never agree on a price, what will happen next?
   d. What would happen if you never agreed on the quantity?
   e. Does this contract need to be in writing? Why? Under what circumstances could this same contract be oral and still enforceable?

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