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Bulletin

Purchases and Sales of Goods Under the Uniform Commercial Code

The Uniform Commercial Code is in effect in all states (but Louisiana has not adopted all Articles) and in the District of Columbia. The Code varies slightly from state-to-state but is essentially uniform as to the fundamental concepts.

The Uniform Commercial Code (UCC) was first published in 1952. It is one of a number of uniform acts promulgated to harmonize the law of sales and other commercial transactions in all the states. This is important because of the prevalence of commercial transactions that extend beyond one particular state (equipment for a project manufactured in one state, warehoused in another, and then shipped to the job in yet another state). The UCC applies primarily to sales of personal property (goods), and not to the sale of real property. Specifically, the UCC does not apply to a construction contract with another contractor or owner involving labor and not just the sale of goods.

The Code consists of 11 Articles, the longest of which is Article 2, entitled "Sales." This bulletin concerns only sales of goods under Article 2, primarily the purchase orders that a contractor writes to material and equipment suppliers. Terms long familiar to contractors, such as FOB, FAS and CIF, are defined in accordance with their generally understood commercial meaning. *Common terms of the sales relationship are prescribed by statute unless the parties expressly agree to the contrary.* Particular attention is given to long term arrangements.

With respect to the sale of goods under Article 2, the Code emphasizes contract concepts rather than property concepts such as title. Prior to the adoption of the Code, the remedies available to a buyer or seller, *and the risk of loss when the goods were destroyed, turned on who had title to the goods when the breach or destruction occurred. Under the Code, the remedies of the parties and the division of risk between them depend upon the duties of performance under the sales contract.* Basic rules are restated in commercial terms by reference to shipment, delivery, acceptance of the goods, and similar functional aspects.

Mechanical contractors will be especially concerned with: warranties, implied and expressed; sale of samples or models; and the relegation of offer and acceptance in the formation of a

contract to their proper place under the theory that the parties to a contract can set their own rights and obligations by agreement. The concepts of *"cover"* and *"cure"* are used. All these features of the Code will be discussed along with other sections of the Code.

WARRANTIES

Section 1 states that the basic commercial tenets of good faith, diligence, reasonableness and care cannot be disclaimed. The Code sets forth two implied warranties that all goods must conform with. These are warranties of merchantability and fitness for purpose. The warranty of merchantability implies that goods purchased conform to ordinary standards of care and are of the same grade, quality and value as similar goods sold under similar circumstances (a candy bar will be fresh and edible). The fitness for purpose warranty implies that when goods are purchased for a specific use, the seller knows of that use and that the buyer is relying on the seller's expertise, then the goods will conform to that use. Disclaimers of the implied warranties of merchantability and fitness for a particular purpose, however, may be disclaimed by contract, but only if the disclaimer is in writing and is conspicuous. Such disclaimers may not be valid in transactions with consumers such as homeowners.

It should be noted that in many cases, particularly in purchase orders involving equipment, manufacturers do in fact disclaim the implied warranties. Contractors need to be cautious to avoid any implied warranties owed to the owner or general contractor under the prime or sub-contract, where the equipment manufacturer has disclaimed those implied warranties. Pass along only the warranties provided by the manufacturer.

The code recognizes third party beneficiaries of certain limited warranties. The warranty extends to any natural person who is in the family or household of the buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this provision.

REMEDIES AND DAMAGES

The UCC sets forth rules to allocate the division of certain risks between parties during shipment of goods and appropriate remedies. However the parties may change those allocations and remedies by contract. Section 2-509 deals with risk of loss in the absence of a breach of contract, and Section 2-510 addresses the effect of a breach of contract on risk of loss. *The theory of risk of loss under the Code is cast in terms of specific rules to resolve specific issues rather than a search for title.* A contractor would do well to be sure his insurance coverage is properly defined to protect him from possible loss under the approach of the Code.

The Code employs the concepts of *"cure"* and *"cover"* for remedies of sellers and buyers, respectively. The concept of *"cure"* by the seller enables the seller to cure a non-conforming shipment if the time for performance has not expired. Thus, a seller who has defaulted because of an improper shipment may thereafter ship the correct item or an undamaged item, thereby "curing" his default, if there is still time remaining for his performance under the agreement.

On the buyer's side, "cover" is an additional remedy. The buyer may purchase goods in replacement after a breach of the contract by the seller and

collect any difference in cost from the seller.

Damages for breach of warranty can be limited by agreement. A limitation of consequential damages for personal injury in the case of consumer goods only, such as a homeowner, is *prima facie* unconscionable, but when the loss is commercial, it is not.

Consequential damages resulting from a seller's breach of contract may include any loss resulting from the general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise. However, the breaching seller may receive some protection, in that recovery for consequential damage is permitted only when the buyer could not reasonably have prevented the loss by "cover" or otherwise. Remember, however, as previously discussed, consequential damages may be limited by contract, and this is a common practice in manufacturers' and suppliers' terms and conditions. A contractor must again reconcile limitations on consequential damages in his purchase orders with material suppliers with the obligations for consequential damages that the contractor assumes under the prime or sub-contract.

When dealing under the Code, your rights and remedies are controlled by the concepts of identification and conformity. *The drafting of an agreement must be done with the points of inspection, acceptance of the material and payment carefully interwoven.*

CONTRACT FORMATION

The Code provides that if the price of the goods is $500.00 or more, writing is required to enforce a contract. Generally that writing need only:

(1) Specify a quantity (which limits the recovery);
(2) Be signed or authenticated by the party to be bound; and
(3) Be sufficient to indicate that a contract of sale was made.

However, a written confirmation of an oral agreement between a mechanical contractor and a supplier may suffice, unless written notice of an objection to the contents of the writing by the party sought to be bound is given within 10 days after he receives written confirmation. Partial payment, as well as receipt and acceptance of the goods, also creates an enforceable contract even without writing.

The common law rule of forming contracts by offers and acceptances is sometimes referred to as the "mirror image" rule; i.e., an acceptance of an offer which attempts to repeat the terms of the offer must reflect those terms precisely. The acceptance cannot add to, subtract from, or change those terms. If it does, it is no longer an acceptance but a counter-offer, rejecting the original offer and requiring, in turn, an acceptance itself for the formation of another contract. Therefore, the only sure way to accept an offer under the prior common law was to endorse the offer by the single word "accepted" and sign it or by simply writing "I accept your offer." But contractors do not have forms so tersely worded.

The Code does not use the "mirror image." Section 2-207 captioned "Additional Terms in Acceptance or Confirmation" provides:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered terms agreed upon, unless

acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) *notification of objection to them has already been given or is given within a reasonable time after notice of them is received.*

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale, although the writings of the parties do not otherwise establish a contract. In such cases, the terms of the particular contract consist of those terms on which the writings of the parties agree, together with supplementary terms incorporated under any other provisions of this Act.

Here you are informed that the parties have latitude to make an agreement in their terms as long as it is done in good faith and does not alter the express limitations set forth in the Act.

Now — *be sure that you are the last man to shuffle the papers if there are terms with which you do not agree, and that you make known your disagreement to the other party "reasonably."* Otherwise, you have an agreement based on the last terms presented (unless your first offer states acceptance is limited to the terms and conditions stated hereon, any modification shall be ineffective unless in writing and signed by both Purchaser and Seller). Without the foregoing statement on your Purchase Order, you may need a score card to keep track of the players in this game. You can see that any two parties can be, and often are, both offerors and offerees.

It should also be clear now that it depends on whether you are "pitching or catching" in this matter of preparing the terms printed on the forms used in present-day business transactions. The clear implication from the language of the Code is that *written confirmation or objection to terms which is not sent within a reasonable time does not operate as an acceptance or rejection.* It is always best to resolve any conflict between the written terms before any performance begins. This is especially important where warranties or express disclaimers of any warranties are involved.

Suggestions:

1. If you do not want to buy material except upon terms included on your Purchase Order, it should include, in conspicuous type, a clause expressly limiting acceptance to the exact terms of the offer.

2. If you are the recipient of a sales or purchase order and want no contract except upon your terms, you need reply only as follows: "I accept your offer (identify it), provided you agree to the following additional (or substitute) terms —." Or, you may reply, "I accept if, and only if, you agree, etc." The exact words depend on you.

3. To be doubly sure that the contract contains all the terms you want included, do not begin performance or take any action recognizing the existence of a contract until all forms have been received by the parties and the terms have been settled.

4. In case of a written confirmation, be sure it is mailed promptly (perhaps in the case of substantial transactions, by registered or certified mail, or e-mail if applicable.)

5. Of utmost importance, any legend on the front side of a form incorporating by reference any terms on the reverse side should be in conspicuous type. Otherwise, there is a danger that a court might construe the reverse side as not having been integrated with the agreement and ignore it. The terms on the reverse side should be in as large and clear type as possible.

UNIFORM COMMERCIAL CODE: HOW IT AFFECTS YOU AND YOUR SUPPLIER

Good faith between merchant and customer cannot be implied. Article II of the Uniform Commercial Code helps you protect yourself against any breach of good faith, especially if unintentional. Since ignorance of the law is no excuse, thorough study of the UCC is essential in the daily conduct of your business.

The Uniform Commercial Code, in effect in the District of Columbia and all states, revises pre-existing commercial law, including sales of goods (except in Louisiana), secured transactions (conditional sales, chattel mortgages, etc.), negotiable instruments (bill and notes), bills of lading and warehouse receipts.

Article 2 of the Code is possibly the most significant to mechanical contractors since it states the law with regard to the formation of sales contracts. A brief review of some of the principal provisions of the Code relating to sales of goods may help you analyze the adequacy of your forms and practices in this area.

UCC OFFER AND ACCEPTANCE

Prior to the Code, in order for a binding contract to exist, the offer to sell or purchase required an acceptance delivered in the manner dictated by the offer, and without qualification or exception to that offer. The Code reflects the law to generally accepted commercial practices. It includes widespread use of printed proposals, purchase orders and acknowledgement forms, which often have differing terms and conditions. Thus, under the Uniform Commercial Code, a contract may be made in any manner that shows agreement, including the conduct of the parties, even though the moment of its making is undetermined. (Example: Supplier ships goods, buyer accepts them.)

Unless otherwise expressly provided in your purchase order, acceptance by the supplier may be made in any manner (i.e., either by acknowledgement form or by delivery of the goods). If you want acceptance in a particular way, you must so specify in your purchase order. The same rule applies to your response to a seller's quotation.

A promise by a supplier to hold a quotation open for a stated period not exceeding three months (i.e., this price is good for fifteen days) may be enforceable even though not supported by consideration; if no time is stated, then it is for a "reasonable time." This irrevocability of an offer may be negated by an express contrary provision in the offer form, or extended beyond three months if supported by consideration. The most important Code provision with regard to use of a proposal, purchase order and acknowledgement forms is 2-207. This section essentially provides that even if your purchase order and the supplier's acknowledgement contain terms and conditions that conflict in some degree, and if there is agreement

as to the principal terms of the sale, a contract may be formed. Under these conditions, a contract is formed when a "definite and seasonable expression of acceptance or a written confirmation" is sent by the supplier, unless the supplier expressly states that his acceptance is made conditional upon your assent to his different or additional terms. In this latter case, there is a contract only when you assent. Under the Code, you may wish to amend your forms to provide that acceptance must be upon the exact terms of your purchase order. If you do, you will have no enforceable contract unless you receive an unqualified acceptance.

A less stringent alternative is to provide in your purchase order that you object to any additional or different terms proposed by the supplier in his acceptance and, even if such terms are included, the contract shall be upon the terms stated in your purchase order.

If you have not qualified your purchase order, if the supplier's acceptance form does vary from your order, and the supplier has not conditioned his acceptance, you must reasonably object to his new terms. Otherwise, you will be bound by them.

TWO REMEDIES FOR RECEIPT OF DEFECTIVE GOODS

Unless your purchase order otherwise clearly indicates, a shipment of defective (non-conforming) goods is an acceptance of your offer to buy, and a contract exists. Your remedies include: (1) rejection of the goods and a suit for damages; or (2) acceptance of the goods and a suit for damages resulting from defects. No contract is formed, however, if the supplier notifies the buyer that shipment is offered only as an accommodation to the buyer.

WHAT CONSTITUTES ACCEPTANCE OF GOODS?

Another important question dealt with by the Code is what constitutes acceptance of goods and how you may reject them. The Code provides that you have accepted the goods if, after a reasonable opportunity to inspect them:

(1) You signify to the supplier that the goods do conform, or in spite of non-conformity, you will retain them;
(2) You fail to make an effective rejection; or
(3) You otherwise treat the goods as your own.

To make an effective rejection, you must notify the supplier within a reasonable time after delivery. What is "reasonable" depends on the facts of each case, especially upon contract terms relating to inspection and upon the difficulty of making the inspection (if it has not been waived in the contract). You should also state in detail the reasons for your rejection. They have an important bearing upon your remedies.

Careful consideration should be given in your purchase order form to include a provision concerning your right of inspection and the time for rejection of non-conforming goods.

The Code provides a four-year statute of limitations for any action for breach of contract, but it permits parties to reduce that period to not less than one year. The statute begins to run from the breach, not from knowledge of it. A breach of a supplier's warranty is deemed to occur when the goods are tendered. This statute, however, is not a limitation on actions founded in tort rather than contract (i.e., claims for personal injury or damage to the plaintiff; reference must be made to the applicable state statute of limitations for such an action).

"SHIPMENT" AND "DESTINATION" CONTRACTS

The Code distinguishes between "shipment" and "destination" contracts. In the former (i.e., FOB place of shipment), the supplier only arranges for transportation to complete his performance. In the latter, (i.e., FOB place of destination), he must deliver to the selected point. In the absence of specific agreement to the contrary, the supplier may use any reasonable carrier or route and make any reasonable arrangements for the shipping. Whether the shipment is or is not at the buyer's expense, reasonable arrangements for the shipping (i.e., protection against the weather, use of specialized vehicles, etc.) are generally the supplier's job. Special contract clauses (i.e., risk of loss, insurance during shipping, special arrangements regarding shipping, etc.) may be desired in your purchase order.

As defined in the Code, the following meanings attach to the indicated terms:

FOB place of shipment: Supplier delivers to carrier and arranges for suitable shipping contract. Risk of loss is on you when this has been done. You pay transportation charge. You have insurable interest when goods are identified to the contract. Supplier has insurable interest until his duties, as above indicated, have been performed.

FOB point of destination: Supplier has insurable interest until his duties, as above indicated, have been performed.

FOB car, vessel or other vehicle: Supplier loads the goods and tenders the documents necessary to give you control over them. You have a risk of loss upon loading and pay transportation charges from that point. The supplier has insurable interest until then. You have such interest as in the two prior forms.

CODE OFFERS BROAD FREEDOM OF CONTRACT

The Code rests upon the requirement of good faith between the contracting parties and renders unenforceable unconscionable bargains. It does, however, permit broad freedom of contract between the parties. As a result, there will undoubtedly be a number of items which your purchase order should contain, or items which you may want to include because they are of special significance to you.

You should also be mindful that in certain instances, the Code distinguishes between commercial transactions (transactions between merchants) and consumer sales. A seller's ability to disclaim certain implied warranties is an example of where the Code makes this distinction.

SUMMARY

This bulletin is intended merely to provide a general outline of the major provisions of the Code. Inasmuch as various states in adopting the Code have in some cases incorporated variations from the proposed Code, it is suggested that the advice of local legal counsel be obtained in reviewing your purchase and sales practices.

This bulletin is not intended to be legal advice. Contractors should seek local counsel for specific information regarding the information found in this bulletin.