Formation of sales and lease contracts

Commercial transactions class
Lecture 1.04

Introduction

Setting

- UCC Article 2 governs contracts for the sale of goods
- The UCC aims to promote the completion of business transactions
- The formation elements for a sales contract are easier to meet and do not require the same level of intent that is required for common law contracts
- The parties are always free to create different terms in their contract

Objective

Today we look at the requirements of a valid contact. At the end of this lecture, you should be able to answer the following questions:

1. How does the UCC change common law requirements for a valid offer?
2. How does the UCC change common law requirements for valid acceptance?
3. What changes does the UCC make in other areas of contract formation?

The UCC and the formation of agreement

The UCC aims to promote the completion of business transactions

- The formation elements for a sales contract are easier to meet and do not require the same level of intent that is required for common law contracts
- Article 2 allows an enforceable agreement to arise so long as the conduct of the parties indicates some basis for a reasonable person to believe a sales contract exists

The Uniform Commercial Code (UCC) allows a contract to be enforced based on

1. Past commercial conduct;
2. Correspondence or verbal exchanges between the parties; and
3. Industry standards and norms.

The UCC modifies the law of offer

What is an offer?

- An offer refers to a promise that one party makes in exchange for another party's performance
- An offer is an invitation to enter into a contract on certain terms
- An offer is a statement of the terms on which the offeror is willing to be bound

The expression of an offer may take different forms

- Offers may be presented in a letter, email, verbally or even through conduct
- The offer communicates the basis on which the offeror is prepared to contract
- Ordinarily, an offer can only be the basis of a binding contract if it contains the key terms of the contract

Offers with open terms

- Sometimes the parties overlook or are unsure about some key element of the contract (e.g., quantity, delivery, payment terms, or the price of the goods)
- The missing provisions, known as open terms, are acceptable under the UCC
  - if there is evidence the parties entered a contract and the other terms are sufficiently articulated to provide a basis for some appropriate remedy in case of breach
- The UCC's approach toward open terms is an example of its gap-filling role

Open price term

- As a general rule, if the parties have not agreed on a price, the court will determine a reasonable price at the time of delivery.
  - Price is based on industry custom and market value
- If one of the parties is permitted to set the price, she must do so in **good faith**

Open payment term

- If the parties do not specify otherwise, payment is due **at the time and the place that the buyer receives the goods**
- The buyer can tender payment using **any commercially acceptable means**
- If the seller demands payment in cash, the buyer must be given a reasonable time to obtain it

Open delivery term

- The UCC provides delivery terms if the contract is silent
- If the parties do not specify the **place**, the buyer will take delivery **at the seller's place of business**
- If the parties do not specify the **time**, the seller will deliver within a **reasonable** period of time under the circumstances

Open duration term

- The UCC permits an open duration term
- Where term is not specified, either party may terminate with reasonable notification

Open quantity term

- Quantity is a term that is generally necessary to create an enforceable contract under both the common law and the UCC.
- The UCC recognizes two exceptions

A **requirements contract** is authorized by the UCC

- Requirements contract: An agreement by which the buyer agrees to purchase and the seller agrees to sell all or up to a stated amount of what the buyer needs or requires

    - For example, a grocery store agrees to purchase all of the apples it needs in a season from one farmer

An **output contract** is authorized by the UCC

- Output contract: An agreement by which the seller agrees to sell all or up to a stated amount of what the seller produces.
- The seller gives up the right to sell the goods elsewhere
    - For example, a farmer agrees to sell all of the apples it grows in one season to one grocery store and the grocery store agrees to buy all of the apples the farmer grows

The UCC imposes a **good faith requirement** on requirements and output contracts

- The actual quantity purchased or sold cannot be unreasonably disproportionate to normal or comparable requirements or output

Termination of an offer

The termination of an offer can occur through various means

- Revocation: The offeror has the power to revoke or withdraw the offer at any time before the offeree accepts it
- Rejection: If the offeree expressly rejects the offer, either orally or in writing, the offer is terminated
- Counteroffer: If the counteroffer proposes different terms or conditions, it operates as a rejection of the original offer

Once an offer is terminated, the offeree can no longer accept it

- If the offeree attempts to accept a terminated offer, their purported acceptance will not create a binding contract

The UCC changes rules of offer revocation

The common law rule

- At common law, an offeror may revoke its offer at any time before acceptance
- Under common law, an offeree must pay consideration promise to keep the offer open for a stated period of time

The UCC creates a special rule for firm offers made by a merchant

- A firm offer is an offer that is irrevocable, even without the payment of consideration
- A firm offer must be written and signed
- A firm offer is available for a limited amount of time

A firm offer occurs

- when a merchant seller promises in a signed writing to keep an offer for the sale of goods open for a period of time
- Does not apply to nonmerchant sellers

A firm offer is limited

- The firm offer is irrevocable for the time stated in the offer but, if no time period is stated, then it will stay open for a maximum of three months
- The offeree does not have to pay any consideration

Acceptance is necessary for mutual assent

The UCC changes common law requirements for valid acceptance

- The rules provided by UCC Article 2 for accepting an offer in a sales contract are not as rigid as the common law rules
- If an offeror does not clearly provide for a method of acceptance, the UCC allows an offeree to accept the offer in any reasonable manner
- Under the UCC, acceptance may still be effective even if the acceptance does not match the offer exactly

The UCC does away with the mirror image rule

- A contract is formed if the response indicates a **definite acceptance** of the offer
- A purported acceptance may still be a counteroffer
- If the parties **act** as if they have a contract, the UCC treats it as a contract

Communication of acceptance

- Acceptance of an offer to buy or sell goods may be made in any **reasonable manner** and by any **reasonable means**
- A party may accept by **promising shipment** of goods
- A party may also accept by a **prompt shipment** of **conforming** goods
- A prompt shipment of **nonconforming** goods constitutes both an **acceptance** and a **breach** by the seller

Battle of the forms

Conflicts between buyer and seller may occur because of the use of preprinted forms or templates

- A purchase order usually contains the offer from the buyer
- An invoice form contains the terms from the seller
- If the purchase order and invoice form have conflicting terms (known as the battle of the forms), the UCC provides guidelines on how to resolve the dispute

In the battle of the forms cases, the UCC provides

- A document may constitute acceptance even though it states terms that are additional to or different from those offered by the offeror, and
- The additional terms proposed in the acceptance may become part of the sales contract, if certain conditions are present

The treatment of additional terms

Treatment of additional terms in an acceptance depends on whether the parties are **merchants** or **nonmerchants**

- If one or both parties are **nonmerchants**, the contract is formed according to the terms of the original offer
- In a battle of the forms case, if one of the parties to a sales contract is not a merchant, the contract is formed as originally offered.
    - The contract is considered accepted.
    - The additional terms are not part of the contract.

How should the contract address additional terms involving merchants?

- If both parties are merchants, the additional terms automatically become part of the contract **unless** certain conditions apply

In a battle of the forms case, if both parties to a sales contract are merchants, the contract is formed automatically including the additional terms unless

- The offeror has expressly and clearly limited acceptance to the original terms
- The additional term is a material change that diverges significantly from those contained in the offer
- The offeror raises an objection to the additional terms within a reasonable time period according to industry standards

The knockout rule

- The knockout rule is used if the terms in the purchasing order are different from terms in the invoice form
- Conflicting clauses knock each other out and neither clause becomes part of the contract.
- Courts then look to the UCC's gap-filler provisions to supply the term

The UCC changes additional areas of contract law

The UCC allows contracts to be modified without any additional consideration

- Common law requires new consideration to modify a contract
- The UCC recognizes
    - Market conditions are not static
    - The parties may have a good faith reason for modifying a contract

The UCC includes an exception to the Statute of Frauds

- Under the UCC, the statute of frauds requires any sales contract for goods with a total value of $500 or more to be in writing

The writing helps ensure

- The parties will take their agreement more serious and consider the consequences of a breach
- One or both of the parties will not come into court and lie about the existence or terms of a contract

Under the UCC statute of frauds provision, the writing must include

- The quantity,
- The signature of the party against whom enforcement is sought, and
- Language that would allow a reasonable person to conclude that the parties intended to form a contract.

If the sales contract is between two merchants

- A signed confirmation memorandum by one merchant satisfies the UCC statute of frauds provision
- The receiving merchant is bound by the memorandum just as if it had signed, unless it promptly objects

The writing must meet certain requirements

- The writing must:
  1. indicate the parties' intent to agree,
  2. be signed by the party against whom enforcement is sought, and
  3. in the case of a contract for sale, state the quantity of goods to be sold or,
  4. in the case of a lease contract, reasonably describe the goods leased and the lease term.

A writing must be **sufficient**

- Between merchants, a written **confirmation** signed by one merchant may be **sufficient**

The UCC broadens the **parol evidence rule**

- Ordinarily, written terms cannot be **contradicted**
- The parties are bound by the "four corners" of the writing
- The UCC expanded the ability of courts to look beyond the writing

Under the UCC, written terms may be explained or supplemented with the following

- Course of performance
- Course of dealing
- Usage of trade
- Consistent additional terms

Conclusion

What did we learn today?

- The UCC changes common law requirements for a valid offer
- The UCC changes common law requirements for a valid acceptance
- The UCC changes additional elements of common law contract formation