

5: EXAMINING COMMERCIAL LAW

- (special notes for this chapter)
 - *risk* refers to who bears the cost if a good is dmgd, destroyed, or lost
 - *merchant* refers to a person or co who sells goods as their normal course of work or business
- UCC Article 2
 - governs laws relating to **sale of goods** (tangible & movable property, other than money)
 - is a model code that has been adopted into state law
- 3 types of specialized sales contracts
 - sales on approval
 - buyer wants to try good before agreeing to buy
 - seller retains title/risk until acceptance
 - sale & return
 - buyer intends to resell goods but can return them if items don't sell
 - seller retains title until buyer's payment/resale
 - buyer's creditors can seize goods if creditors were not on notice of seller's interest in goods
 - auction sales
 - at auctions **w/o** reserves, seller **must** sell to highest bidder
 - at auction **w/** reserve, seller has right to reject offers that aren't above reserve price
 - bidders can retract bid before auctioneer announces completion of sale
- formation of sales contracts
 - offer
 - must be definite enough that the parties u/s their obligations
 - may have 1+ terms open if parties intended to form contract & there is a reasonable basis on which breach can be calculated
 - acceptance
 - if offer doesn't say method of acceptance required, any reasonable manner is ok
 - if acceptance includes add't/diff terms:
 - if one party is non-merchant, the non-merchant must agree to terms before contract is binding
 - if both parties are merchants, new terms **automatically** become part of contract unless:
 - acceptance is expressly conditioned on seller's consent to new terms
 - terms would materially alter contract
 - original offeror objects w/i reasonable time
 - consideration
 - especially essential to sales contracts
 - contrary to normal contract law, consideration is **not** required to modify contract
 - statute of frauds
 - applies to sale of goods for \$500 or more
 - allows defendant to avoid contract if there is no contract in writing w/ **defendant's** signature
 - 3 exceptions:
 - buyer accepted & received part of goods
 - buyer has made any part of payment for goods
 - goods were made specifically for buyer:
 - goods aren't suitable for resale to others in ordinary biz
 - seller made substantial commitments/actions to begin
 - does **not** require **plaintiff's** signature to be present

- issues surrounding sales contracts
 - risk of ownership for goods
 - refers to who bears cost if goods are dmgd/destroyed
 - usually transfers w/ title, unless goods remain w/ a seller who is a merchant
 - in that case, risk doesn't transfer until buyer receives goods
 - if buyer rejects goods that don't conform w/ contract, risk remains w/ seller until seller fixes problem or buyer accepts goods
 - delivery terms (who has risk while goods are in transit)
 - key terms
 - "free" → seller is "free" of risk
 - FOB = "free on board"
 - *carrier* refers to shipping co
 - FOB shipment – risk transfers when seller delivers to carrier
 - FOB destination – risk transfers when carrier delivers to buyer
 - FAS (free alongside) vessel – risk transfers when seller delivers goods alongside vessel for loading
 - FOB vessel – risk transfers when goods loaded onto vessel
 - CIF (cost ins freight) – seller obligated to pay for ins & freight (shipping) charges
 - CAF (cost & freight) – seller obligated to pay for freight charges but **not** ins
 - inspection
 - buyer usually has right to inspect before payment & acceptance
 - 2 exceptions:
 - if contract requires buyer to pay at delivery of **title**
 - **COD (collect on delivery)**: when buyer must pay upon **delivery** of goods w/ no right to inspection
 - delivery must occur w/i reasonable time (if no timeframe specified in contract)
 - conformity of goods (goods must match what is promised in contract)
 - non-conformity usually considered breach of contract
 - 2 exceptions
 - if seller informs buyer that shipment is accommodation (counteroffer for substituted goods)
 - seller notifies buyer of intention to "cure" (deliver confirming goods) before time for contractual performance has expired
 - warranties
 - promises made by seller about a good
 - **sellers' liab for warranties can extend to 3rd parties who aren't immediate buyers or consumers**
 - 3 types of **express** warranties
 - affirmation of fact about goods (i.e., when you say something about the goods)
 - description of goods in contract
 - contract based on sample/model (i.e., that goods will be the same as sample/model)
 - **implied** warranties
 - merchantability
 - applies only when seller is a merchant

- includes 5 warranties:
 - must pass w/o objection in trade under contract description
 - i.e., outside parties would agree that good matches description
 - ex: if you are selling a car, most people would agree that “car” is an accurate description of your good
 - fungible goods must be indistinguishable, interchangeable, and of avg quality (ex: all pieces in load of gravel will pretty much be the same)
 - fit for the **ordinary** purpose for which they will be used
 - (ex: if lid falls off & person burned by hot drink, it was not fit for its ordinary purpose)
 - applies even if buyer didn’t tell seller how he planned to use product
 - all goods in a batch/lot must be approximately like kind/quality
 - must conform to specifications on label/container
- fitness for **particular** purpose
 - if buyer tells seller he is looking for a something to accomplish a specific goal
- implied warranty of title
 - seller has legal ownership of good & no knowledge of any other legal claim to it
 - warranty may be waived if it is clear that seller is selling for someone else (ex: real estate agent)
- to sue for breach, buyer must first give seller notice of rejection & state defect/reason
- when buyer can revoke acceptance
 - buyer reasonably assumed seller would cure defect but seller didn’t
 - buyer accepted goods before discovering non-conformity
 - buyer accepted goods b/c it would’ve been difficult to discover defect & b/c of seller’s assurances of quality
- excuses for non-performance (i.e., when its ok to not perform exactly to contract)
 - loss of specified goods before risk transfers to buyer
 - substituted performance
 - if agreed on carrier or facility becomes unavail, seller can use reasonable substitute
 - if agreed payment method fails due to govt regulation, seller can withhold delivery unless buyer provides commercially equivalent means of payment
 - failure of pre-supposed condition
- remedies
 - for seller
 - if buyer insolvent:
 - refuse to deliver goods if learn of insolvency before delivery
 - if goods enroute, stop delivery unless carrier/warehouse notified buyer that it is holding goods or buyer already rcv’d title
 - demand return of goods w/i reasonable time period
 - seller can sue if buyer:
 - buyer wrongfully repudiates/denies contract
 - buyer wrongfully rejects goods
 - fails to make payments that are due before delivery
 - if goods being manufactured at time of breach, seller can sell unfinished or finished good to another party for partial pay & sue for diff

- if buyer fails to pay after accepting goods or after liab passes to buyer, seller can sue even if seller possesses goods if seller can't sell to another party at reasonable price
- for buyer
 - if seller repudiates/denies contract or fails to deliver, buyer entitled to diff btwn contract price at time buyer **learned** of breach & mkt price
 - buyer entitled to force seller to perform if goods are unique or buyer can't get them from another source
 - buyer can buy substitute goods w/i reasonable time of learning of breach & recover diff from seller
 - buyer who accepts non-conforming goods & informs seller of such is entitled to diff btwn accepted goods & conforming goods
- *negotiable instruments/commercial paper*
 - **written documents** that promise the holder a specific payment and that are negotiable (can be transferred from person to person)
 - with cash, seller is getting their payment right here & right now
 - with negotiable instrument, you can send payment to seller who is away from you, set payment to occur at future date, or transfer the promise of payment to others
 - governed by UCC Article 3
 - 4 requirements:
 - signed by maker/drawer
 - contains unconditional promise to pay & no other promises, except as provided by Article 3
 - payable on demand (immediately) or at definite time
 - payable to order/bearer
 - 2 categories
 - drafts (**orders** payment to be made)
 - notes (**promises** that a payment will be made)
 - 4 types
 - draft (checks)
 - certificate of deposit (CD) (issued by financial institution, promising to repay w/ interest)
 - promissory note
 - like a contract that says one party promises to repay another
 - similar to CD, but not issued by financial institution
 - trade acceptance
 - two-party draft used when seller wants cash but buyer can't provide it until goods sold
 - works like a promissory note, but you can sell it to others at a discount
 - seller delivers goods & sells trade acceptance at discount for immediate cash
 - buyer pays new holder of trade acceptance
 - *drawer/maker*:
 - party who creates negotiable instrument in someone's favor
 - (ex: the person writing a check)
 - has primary liab (ultimately responsible to pay a negotiable instrument according to its terms)
 - only liab if drawee fails to pay
 - *drawee*: party who will make payment on behalf of the drawer (ex: the bank)
 - *holder*
 - someone who possesses a negotiable instrument & is entitled to receive payment
 - new holder has same right to enforce payment as original holder had

- *endorsement*
 - signature (or equivalent) to legally transfer negotiable instrument to a new holder
 - types
 - special – specifies to whom instrument is payable to
 - blank/general – names no specific payee
 - restrictive/collection – includes language placing addt limitations on negotiation
 - qualified – limits endorser's liab to later holders if instrument is dishonored ("w/o recourse")
 - unqualified – places **no** limits on endorser's liab on the paper
 - (can be more than 1 of these types, such as "unqualified special endorsement")
- secondary liab:
 - obligation to pay instrument only if someone else refuses to pay/accept instrument
 - (ex: when you co-sign for someone)
 - can apply to anyone who endorses instrument and transfer it to another party
- *holder in due course:*
 - refers to a special category of holder
 - person to whom an instrument has been issued/endorsed who possesses it for value in good faith w/o notice that it may be invalid/overdue/dishonored
 - i.e., innocent party who exchanged good or service for instrument & didn't know it is bad or invalid
 - most holders qualify as *holders in due course*
 - (ex: if A gave B a ck for purchase & B then signs it over to C but A puts a stop-pay, C can still cash ck against A)
 - **cannot** be *holder in due course* if you got instrument under these circumstances:
 - purchased instrument at judicial sale or took it under a legal process
 - acquired when taking over an estate
 - purchased as part of a bulk transaction **not** in regular course of transferor's biz
 - used fraud/illegality to obtain
 - had notice of defense against or claim to instrument
 - personal defense
 - defenses that **can't** be used against a holder in due course to deny payment
 - includes any defense you'd use in a simple contract dispute
 - real defense
 - defenses that **can** be used against any holder, including holders in due course to deny payment
 - includes defenses relating to existence of instrument itself
 - examples:
 - incapacity of parties involved
 - duress
 - illegality
 - discharge in bankruptcy
- documents of title
 - comes into play when goods are being shipping/stored
 - holder of title has ownership rights to goods & can receive/hold/dispose of goods for owner
 - governed by UCC Article 7
 - bailee: person who temporarily possesses another party's property
 - bailor: actual owner of prop

- 3 required elements of a doc of title:
 - created by bailee as receipt for goods rcv'd
 - is a contract to ship or store goods
 - if negotiable, contains statements that:
 - holder has right to receive, hold, dispose of both goods & title
 - purchaser of title does so free of claims/defenses of prior parties
- must be issued/addressed to **bailee w/ purpose of covering the goods in bailee's possession**
- warehouse receipts:
 - provides title to goods in storage & assures delivery to holder of warehouse receipt
 - 9 required items
 - warehouse location
 - date receipt is issued to bailor
 - receipt #, showing consecutive numbering of all receipts issued by warehouse
 - statement indicating party to whom goods will be delivered at end of storage period
 - storage rate & handling charges
 - description of goods or their packages
 - warehouse rep's signature
 - statement of ownership if warehouse is owner or partial owner of goods stored
 - statement indicating amt of any advances made or liab incurred for which warehouse claims security interest
 - **parties can limit liab through terms in warehouse receipt or storage agreement**
- bill of lading: (BOL)
 - given by shipping co, includes shipment contract terms & acknowledges receipt of goods from shipper
 - consignor: party shipping goods
 - consignee: party receiving goods
 - 2 most common types:
 - straight BOL **[non-negotiable]**
 - names consignee & obligates carrier to deliver goods to consignee only
 - consignee **cannot** transfer goods to other party prior to delivery & tell carrier to just deliver to that party
 - order BOL **[negotiable]**
 - allows consignee to transfer goods to other party & tell carrier to deliver to them
- secured transactions
 - when buyer gives collateral to seller to guarantee payment
 - 5 elements
 - debtor
 - secured creditor
 - collateral (cash or asset that a debtor pledges to secure a debt or obligation)
 - security agreement
 - security interest (interest in prop, which gives creditor right to sell the prop to satisfy debt if debtor defaults on payments)
 - governed by UCC Article 9

- main forms
 - **pledge: creditor keeps the good until payment has been made or service performed**
 - chattel mortgage:
 - debtor keeps possession, but creditor has right to take ownership/title
 - **debtor can pay amt in default + reasonable expenses incurred by creditor to redeem the collateral**
 - *conditional sale*:
 - form of chattel mortgage where seller acts as financier/lender
 - if debtor doesn't make payments, seller (creditor) can take back the sold good
- 5 forms of collateral
 - consumer goods
 - equip (items used in business/govt)
 - farm products (produce/livestock)
 - inventory
 - property on paper
 - papers that serve as evidence that debtor's has rights in a personal prop
 - ex: lienholder w/ title on a car can use title as collateral when borrowing money for themselves
- *attachment*
 - legally creating a security/collateral interest in a prop
 - 3 requirements
 - a consensual security agreement exists btwn debtor/creditor
 - creditor must give value/consideration (such as loan money, forgiveness of debt, etc.)
 - **debtor must have (ownership) rights in collateral**
 - does **not** protect against claims to prop by parties other than the debtor (i.e., if debtor owes other people money, they can make claim to prop too)
- *perfection*
 - like attachment, but more formal
 - preferred over attachment b/c it protects against other creditors' **non-perfected** claims
 - perfected creditors get priority for their debts to be settled
 - after theirs are resolved, remaining funds go to attached creditors
 - perfected security interest:
 - agreement that has been filed w/ appropriate court to provide a priority interest over others who may also have interest in same prop
 - gives constructive notice to others about your interest in prop (knowledge that others are presumed to have by law)
 - **obtained by filing financing statement** w/ 3 elements:
 - names/addy of debtor/creditor
 - debtor's signature
 - general description of collateral prop
 - financing statements are valid for 5 yrs & can be renewed as many times 5 yrs at a time
 - superior to all interests **except**:
 - holder in due course
 - artisan/mechanic's lien
 - if borrower sells collateral prop to someone who is 1) in the biz of selling that kind of good & 2) didn't know sale violates the borrower's security agreement w/ lender
- *termination statement*: evidence that a secured debt has been paid in full

- parties who bought goods from a non-merchant & didn't know about secured interest have **higher priority** interest than secured parties
- creditors often require borrower to buy ins on collateral prop
- default
 - forms of default
 - non-payment
 - failure to insure collateral
 - debtor's bankruptcy
 - loss/destruction of collateral
 - removal of collateral to another place
 - ways to foreclose on collateral property
 - sue on underlying debt (sue debtor for amt owed but don't take collateral)
 - strict foreclosure (if creditor **already has** collateral, keep it for full satisfaction of debt)
 - **not** permitted for consumer goods if borrower paid at least 60% of loan
 - creditor can repo item w/o court order if creditor can do so w/o breaking law
 - sell collateral
 - dispose of collateral as desired
- fair trade laws
 - protects consumers by limiting **restraints on trade** to ensure a competitive marketplace
 - Federal Trade Commission Act (**encourages free competition**, anti-monopoly)
 - fights unfair methods of competition
 - fights unfair or deceptive acts/practices that affect interstate commerce
 - not specific only to competition/monopolies
 - does **not** apply to ins industry
 - per McCarran-Ferguson Act, Fed govt generally doesn't regulate ins industry b/c ins is **subject to state regulation**
 - establishes 5-member commission who takes action in 3 ways
 - **hold trade practice conferences**
 - cease & desist orders
 - informal settlements & consent orders used to settle cases from violations
 - state unfair trade practice acts
 - unfair acts (oppressive or bad-faith conduct)
 - deceptive acts (fraud, deceit, misrepresentation)
 - unfair methods of competition (ex: price fixing or group boycotts)
 - consumer warranty laws / Magnuson-Moss Warranty Act
 - assures product is fit for the purposes for which product will be used
 - required disclosures in a written warranty
 - what it will/won't cover
 - when it expires
 - to whom it applies
 - what warrantor will do if malfunction occurs
 - what service/parts are free
 - how to obtain redress (service)
- consumer credit laws
 - protections provided:
 - fair access to credit
 - right to know/understand terms/interest of a loan prior to agreeing to take on loan

- access to credit reports & means to correct/repair them
- methods for resolving credit disputes/discrepancies
- Truth in Lending Act
 - to ensure consumers know terms & interest rate of credit transactions
 - finance charges must be disclosed
 - prohibits companies from issuing credit cards to those who don't request/apply for them
 - limits cardholder's liab to \$50 for unauthorized use one cardholder notifies co issuing card
 - allows cardholder to withhold payment w/o incurring finance charge until transaction disputes are settled
 - Fair Credit Billing Act – gives person right to not pay remaining amt due for unsatisfactory goods/services if he first tries in good faith to return prop or give merchant chance to correct problem
 - Fair Debt Collection Practices Act (provides rules for debt collection)
- Electronic Funds Transfer (EFT) Act
 - buyers do **not** have right to stop-pay EFTs
 - a person's liab is limited to \$50 if card is lost/stolen & owner reports w/i 2 biz days
- Fair Credit Reporting Act
 - 3 circumstances when a credit agency can disclose credit report to others
 - court order
 - under written instructions of person
 - to person who intends to use info in connection with:
 - credit transaction
 - for employment purposes
 - insurance underwriting
 - to determine eligibility for biz license
 - for legitimate biz need for info in connection w/ biz transaction
 - consumer must receive notice of if recipient of report refuses of credit/ins/employment
- Equal Credit Opportunity Act (prohibits credit discrimination based on age, race, color, religion, national origin, welfare status)
- bankruptcy
 - Chap 7
 - "last resort"
 - sell & distribute assets among creditors
 - creditors paid in following order of priority:
 - secured creditors
 - those entitled to received unsecure monies from debtor
 - employees
 - unsecured lenders
 - govt
 - balance of debts owed is discharged (waived)
 - purpose is to give fresh start
 - **not** automatic
 - not avail to liquidating corps/partnerships
 - if person was bankrupt in last 6 yrs, discharge request will be denied

- Chap 11
 - s/u payment plans w/ creditors
 - used primarily by:
 - large corps
 - partnerships
 - individuals with a lot of debt
- Chap 13
 - same as Chap 11, but used primarily by small bizs and individual wage earners
- anyone can file for bankruptcy voluntarily
- creditor can force bankruptcy filing if:
 - they believe that a bankrupt person /entity is favoring other creditors
 - they dispute remaining assets of debtor's estate (i.e., they think debtor is hiding assets)
- trustee is responsible for making inventory of assets & selling them off as economically as possible
- assets that are **exempt** from bankruptcy sale:
 - limited homestead exemption (debtor's primary residence, up to a certain value)
 - tools of trade (work tools)
 - life ins
- debts that **cannot** be discharged
 - certain tax clms
 - money, prop, services obtained by fraud
 - clms for willful & malicious inj to people/prop
 - alimony/child support
 - most student loans
 - debts incurred in court actions from DUI