The New (and Improved) Article 2 to the UCC

In case you have not yet heard, a new—*albeit* amended—Article 2 (Sales) to the Uniform Commercial Code (UCC) may be coming real soon to your state. Recently, after a lengthy process, certain amendments to Article 2 were adopted by its drafters, the National Conference of Commissioners on Uniform State Laws and the American Law Institute.

Those amendments have now been referred to several states for consideration as possible legislative amendments to their state commercial code. These UCC amendments will trigger the necessity of all buyers and sellers to "revisit" their organizational terms/ conditions of purchase/sale, negotiation "tactics" and the like—including those appropriate in supply chain contract management/administration. With state/federal government(s) focusing more frequently on commercial purchases, government contracts officers at all levels are not immune from these amendments.

This article is intended to provide an overview of significant non-consumer amendments to UCC Article 2.

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Background, Introduction, Scope

First, recall that UCC Article 2 is the "Bible" for contracts/purchase orders for the sale/purchase of goods in the United States. It applies to transactions in "goods," as defined in UCC 2-103, and thus impacts all buying and selling professionals within the United States (UCC 2-102). The typical boilerplate terms and conditions incorporated into domestic sales transaction—explicitly or implicitly—usually have the law of a particular state apply to that sales transaction.

This has as the operative effect of allowing that state's commercial law to control and influence the outcome of many transactions. This arises due to local/domestic law accomplishing what the UCC intended, filling the gaps in various aspects of the deal that was structured by the contracting parties. No change is proposed to UCC Section 1-102(3), however, which allows the contracting parties to continue to "vary by agreement" the UCC—with very few exceptions that are not applicable here.

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BY CHARLES E. RUMBAUGH

Furthermore, leasing of goods continues to be outside the scope of Article 2 and is covered in Article 2A, which is unaffected by these amendments.

It must also be realized that the UCC and state law will normally not control international sales transactions in goods where the contracting parties are situated in different countries each of which have ratified the United Nations Convention on Contracts for the International Sale of Goods (CISG). Thus, for those 60+ countries (including the United States) that have ratified the CISG, that law provides the commercial law benchmark in the sales of goods in that arena—and there are significant differences (e.g., no "Statute of Frauds," "different" shipping terms, no "battle-of-the-forms" concept, etc.) in contract formation/terms that are included in the current UCC and should be appreciated by the buying and selling professional *before* conducting business in that international environment—all of which is beyond the scope of this article.

Significant Changes to Article 2

Generally, the changes to Article 2 are predicated upon updating "the article to accommodate electronic commerce... and also to reflect the development of business practices, changes in other law, and to resolve some interpretive difficulties of practical significance." It is submitted that global transactions in this era of WTO, NAFTA, and other free trade agreements are dynamic and impact so-called purely domestic transactions —this necessarily has driven change in the underlying basis in most laws and thus requiring "updating."

The significant changes in Article 2 may be characterized under the major headings of definitions, formation and terms, warranties, performance and breach, and remedies.

Definitional Changes

The basic definition of "goods" is unchanged, in that it continues to include "all things that are movable at the time of identification to a contract for sale," as well as future goods and specially manufactured goods. However, it now *expressly excludes* "information" from its definition (UCC 2-103). There are also special rules for mixed transactions involving the sale of goods/information that are not too dissimilar from that that currently exist for services/goods. Consequently, the "pure" electronic transfer of information is not subject to Article 2.

Yet, there are many changes (UCC 2-103) that "accommodate electronic commerce" including

- Changing the term "writing" to "record" (throughout Article 2) and is defined as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form;"
- Adding new terms of "electronic," "electronic agent," and "electronic record," with the latter being defined as "a record created, generated, sent, communicated, received, or stored by electronic means;" and
- Changing the meaning of "sign" to "with present intent to authenticate or adopt a record (i) to execute or adopt a tangible symbol, or (ii) to attach to or logically associate with the record an electronic sound, symbol, or process."

UCC 2-211 is new and provides that "a record, signature, or contract cannot be denied legal effect and enforceability merely because it is electronic in form."

Contract Formation and Terms

With this new and improved Article 2, the world of e-commerce as applied to

UCC transactions has arrived. This becomes reinforced when applied in the context of contract formation, including the increased dollar threshold for the Article 2 "Statute of Frauds" (UCC 2-201). "A contract for the sale of goods for the price of $5,000 or more is not enforceable…unless there is some record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against which enforcement is sought." Therefore, electronic communications—called a "record"—could have a significant role in the formation of a contract for sale and, in particular, for a contract amount in excess of $5,000.

This becomes remarkable, since the UCC continues the practice of not requiring a contract price (as well as other "elements" forming the basis of a contract) to be settled upon by the parties to find that a contract has been formed (UCC 2-305). The buying/selling professionals must be cognizant that contracts can be "formed" through the use of electronic "communications," including e-mails, when that may not have been subjectively intended. Those professionals should (continue to) have electronic protocols/conventions in place with their customers/suppliers or trading partners and be observant to the use/abuse of electronic communications in business development and marketing areas of responsibility.

Another major change in the formation area is that which was alluded to earlier as the long running "battle-of-the-forms" embedded in the current UCC 2-207. Briefly, this current section of the code specifies the legal effect of every piece of correspondence exchanged in the multitude of steps that can lead to contract formation and terms that constitute that contract—a two-pronged driving force behind this section of Article 2. This has been described by some as the "curse" for all (new) professionals and can be an easy pitfall for the uninitiated, especially when s/he finds that a contract may not have been formed or the terms of their contract are not what they expected—all as a result of engaging in this historic and UCC-unique "battle-of-the-forms."

Suffice to say that one would not recognize the new, improved, and streamlined UCC 2-207! Section 2-207 no longer deals with issues of offer and acceptance—"this section only applies when a contract has been created under another section" of Article 2 (e.g., UCC 2-204 or 2-206). There is no longer any preference for which is the first "form" or the last "form" to be exchanged—all critical in the current UCC 2-207 scheme. Succinctly stated, Section 2-207 now applies to all contracts and is only concerned with the terms that constitute the contract, i.e., those "terms that appear in the records of both parties, terms to which both parties agree, and supplemental terms under the UCC."

Therefore, it will now be a question of "sorting out" the correspondence, or "records," to answer the question as to what are the terms of the contract that was formed. And, it should be noted in this context of "terms of the contract," that UCC 2-202 "has been amended to clarify that a finding of ambiguity is not a prerequisite to an admission of evidence of a course of dealing, course of performance, or usage of trade for the purpose of explaining a term (in the contract)."

However, returning to the "formation" issue, here is an example from the official comments to these amendments, which may be of added guidance on the core formation question.

> When one party insists in that party's record that its own terms are a condition to contract formation, if that party does not subsequently perform or otherwise acknowledge the existence of a contract, if the other party does not agree to those terms, the record's insistence on its own terms will keep a contract from being formed under Sections 2-204 or 2-206 and this section (2-207) is not applicable.

The formation of a contract is a prerequisite to the application to the new Section 2-207. The reference to Section 2-204 deals with contract "formation in general," whereby "a contract for sale of goods may be made in any manner sufficient to show agreement," including conduct of the parties, interaction of electronic agents, and performance. Plus, the new Section 2-206 provides that "a definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer."

Accordingly, "a purported expression of acceptance containing additional or different terms would not be a 'definite' acceptance when the offeree's expression clearly communicates to the offeror the offeree's unwillingness to do business unless the offeror assents to those additional or different terms." Thus, any standard forms/approaches used in prior correspondence by buyers and sellers may have to be re-visited.

Other parts of Article 2 changed by these amendments are shipping terms (e.g., FOB and CIF)—specifically, former Sections 2-319 through 2-324 that dealt with shipping terms have been deleted from Article 2. These sections "were eliminated because they are inconsistent with modern commercial practices." The official comments added the following, "the effect of a party's use (under this new article) of shipping terms such as 'FOB' or 'CIF,' absent any express agreement to the meaning of the terms, must be interpreted in light of any applicable usage of trade and any course of performance or course of dealing between the parties." Again, the code fills the gap.

As an aside, this change brings the UCC into "conformance" with the current practice in global trade. The CISG has long recognized that shipping terms are best addressed by using a similar "exclusionary" approach—the CISG also does not include shipping terms. While buyers and sellers should be cautious in fully understanding any contract terms they use, it is of utmost importance here, as this has significant implications on various issues including risk of loss, delivery location, insurance, carrier, and expenses.

While some contractors draft specific contract language to cover those

issues, INCOTERMS (abbreviation for "international commercial terms"), published by the International Chamber of Commerce, are used in international trade (which must be expressly incorporated into the contract) and may be a viable alternative to drafting something distinctive for each and every one of those issues. The current version of INCOTERMS (2000) has 13 shipping terms—from Ex Works (EXW) to Delivered Duty Paid (DDP)—and each is targeted for individually defined situations and are understood by international trading companies. It is not recommended that INCOTERMS be tailored or modified.

Other aspects of the Code that may be of interest in this area of formation/terms are as follows:

- Contract terms may continue to be found to be "unconscionable," by severing the term or limit its application to avoid an unconscionable result (UCC 2-302);

- While the definitions for "termination" ("a party puts an end to the contract otherwise than for breach"—UCC 2-106) and "cancellation" ("a party puts an end to the contract for breach by the other party"—UCC 2-106) remain unchanged, UCC 2-309 was modified to read as follows:

  > Termination of a contract by one party *except* on the happening of an agreed event *requires* that reasonable notification be received by the other party and *agreement dispensing with notification is invalid if its operation would be unconscionable*. A term specifying standards for the nature and timing of notice is enforceable if the standards are *not manifestly unreasonable.* (emphasis added)

This may be of importance in those commercial contracts that "increasingly" use a "termination for convenience" clause, prevalent in government contracting. The last sentence quoted above is new, and the official comments add that this "provides for greater autonomy. In appropriate circumstance, the parties may agree that the standard for notice is no notice at all."

In summary, after a contract is made between the parties, those terms and conditions that appear in the records of both parties, terms to which both parties agree, and any supplemental terms under the UCC will be the basis of the deal. Again, the UCC will be the "filler" when the parties —by design or otherwise—do not supply all the terms and conditions. Buyers and sellers should revisit those terms and conditions that are material to the deal and see that they are included in the contract—expressly or by default through other UCC provisions.

Warranties

In the area of warranties, it may be of assistance to provide "what continues" in the amended article without significant changes. That includes, for example, implied warranties of merchantability, course of dealing, usage of trade (UCC 2-314), and implied warranty of fitness for particular

purpose (UCC 2-315).

Section 2-312 has been amended to bring into the text what was formerly in the comments—that is, the warranty of title is breached if the sale "unreasonably exposes the buyer to litigation because of a colorable claim or interest in the goods."

"Remedial promises" are defined as "promises by the seller to repair or replace goods or to refund all or part of the price of goods upon the happening of a specified event" (UCC 2-103). Section 2-313 is directed at "remedial promises" that flow only to the immediate buyer (not remote user/buyer) and is dealt with separately and distinctly from the concept of warranty "to (also) deal with a statute-of-limitations problem" if it was deemed a "warranty." Here, "a cause of action accrues if a remedial promise is not performed when performance is due" (UCC 2-725).

There are new so-called "pass-through warranties" for transactions "within the normal chain of distribution" that are placed under the rubric of "obligations," since they do not flow directly to the immediate buyer—who is in privity with the seller—and would otherwise be called "warranties."

> New sections 2-313A and 2-313B "create statutory *obligations* in the nature of express warranties that run directly from a seller to a remote purchaser that is not in privity…and excludes liability for statements that are mere opinion, *permits the seller to modify or limit remedies* as long as the modification or limitation is provided to the remote purchaser at or before the time of purchase, and *excludes recovery for consequential damages in the form of lost profits*. (emphasis added)

These "obligations" should be carefully reviewed, but in essence, they relate to "packaging" or accompanying statements regarding seller's obligations and description of the goods. The Code provides that an "obligation may arise without using (any) specific words that could create same." Remedies can also be modified/limited if done in a timely manner (UCC 2-313A). "Obligations" under UCC 2-313B relate to similar "statements," provided they were created in "advertisements or similar communication to the public."

Significant changes in the area of excluding/modifying consumer warranties are provided in UCC 2-316.

Performance and Breach

Changes have also been undertaken in the areas of acceptance, rejection, and revocation within the context of contract performance.

A conforming change in the criterion for "rejection" (as compared to the criterion for "revocation" under UCC 2-608) for deliveries that are part of an installment contract is that they may be rejected when the installment's value to the buyer is substantially impaired (UCC 2-612). The prior "right" to an opportunity for the seller to "cure" has been deleted in this conforming change. Further, a "buyer's reasonable use of goods after rejection or revocation of acceptance is not an acceptance of the goods, but the buyer may be obligated to pay for the value *of the use to the buyer*"—this codifies some case law in the area (UCC 2-602 and 2-608).

Under UCC 2-508, a "seller has a right to cure (when appropriate and timely under the circumstances) if the buyer justifiably revokes acceptance under UCC 2-608." And, the buyer's absence of specificity in conjunction with a revocation of acceptance, i.e., without the required "particularity (of) a defect (that is) ascertainable by reasonable inspection," could give rise to not insignificant consequences to the buyer under UCC 2-605. Finally, if any performance aspect—not merely a delivery—is late, the seller may be able to (now) provide any commercially reasonable substitute that is available if that performance otherwise becomes commercially impracticable" (UCC 2-614 through 2-616).

Remedies

Some of the time periods for the exercise of certain rights to "reclaim" goods has been changed to a "reasonable time," rather than the previously fixed time of 10 days after delivery (UCC 2-702). And there are several other conforming and clarifying changes that would necessitate detailed review by interested readers.

The following items may be of particular interest in the area of remedies:

- "The test for enforceability of a liquidated damage clause is limited to the reasonableness of the clause in light of the actual or anticipated harm" (UCC 2-718). The stated intent here is to mitigate the prior language that "suggested" that some amounts may be deemed void as a "penalty."
- The general Statute of Limitations period "has been amended from a flat four years to 'one year after the breach was or should have been discovered, but no longer than five years after the right of action accrued'" (UCC 2-725). However, this can be reduced by agreement of the parties.

Conclusion

Finally, the new and improved Article 2 to the UCC is here! It will be appearing before your state legislature for its consideration and, when adopted, will be the new commercial law for your state. This action will necessitate professional buyers and sellers re-examining their tactics in negotiation, correspondence, contract terms/conditions, and contract management practices within a framework of the changed UCC provisions—some of which were highlighted in this article.

Significantly, the "battle-of-the-forms" is over! No longer will contract formation and deal terms be determined by an outdated convention based upon who is first or last in the transmittal of a document. Reasonable commercial rules that are in many respects recognizable by global trading companies are an excellent step forward into the 21st century. Buying and selling professionals will need to have an increased awareness of these commercial changes and continue to exercise diligence in this electronic age of commercial contracting. CM