Chapter 3. Formation of a Contract under the UCC

3.1. Common Law Principles of Contract Formation. Common law has developed principles governing formation of a contract, including the requirement of mutual assent between the parties manifested through an offer and acceptance. Early in its development, the common law was strict, making it difficult at times to form a contract.

3.1.1. Under the early *mirror image rule*, the terms of the acceptance had to exactly mirror the terms of the offer in order for a contract to be formed. Furthermore, the manner of acceptance (promise or performance) had to be the same, as did the medium of acceptance (letter, telegraph, etc.). For example, if an offer to sell a horse was delivered to a potential buyer in a telegram, the buyer could accept the offer only by telegram, and not by letter and not by performance. However, even before the UCC was adopted, these strict rules of contract formation were being relaxed by the courts and legislatures. See, for example, *Hammersberg v. Nelson*, 224 Wis. 403 (1937) (oral acceptance of a written offer was sufficient to form a contract). Reflecting current common law, the *Restatement (Second) of Contracts* § 30 (1981) provides: "Unless otherwise indicated by the language or the circumstances, an offer invites acceptance in any manner and by any medium reasonable in the circumstances."

3.1.1.1. Even though common law has relaxed the rules of offer and acceptance, many courts require a "mirror image" acceptance of the terms proposed. In other words, a purported acceptance is not effective if it adds new or differing terms from those proposed; instead, it is a counter-offer. See *Restatement (Second) of Contracts* § 59 (1981): "A reply to an offer which purports to accept it but is conditional on the offeror's assent to terms additional to or different from those offered is not an acceptance but is a counter-

offer." If a seller offers to sell a horse for $2,000, and the buyer replies, "It's a deal if you include the bridle," then there is no acceptance. The buyer's response is a counter-offer.

3.1.2. At common law, a contract cannot be formed if ***essential terms are missing***. In *Drug Fair Northwest v. Hooper Enterprises, Inc.*, 733 P.2d 1285 (Mont. 1987), the court determined that a letter regarding the lease of property did not form a contract. Although the letter referenced the lease of a specific property and the rental amount, it did not specify the commencement date of the lease or the responsibility of the parties for taxes, insurance, repairs, maintenance and utilities. In addition, the letter provided for renewal terms, but failed to specify the rental amount for the renewal periods.

3.2. Relaxed Formation Rules under the UCC. As noted by the Montana Supreme Court in *Conagra, Inc. v. Nierenberg*, 7 P.3d 369, ¶ 28 (Mont. 2000), "the UCC rules governing sales agreements are far more permissive in this respect than the general common law rules governing contract formation." The party trying to avoid a contract for the sale of grain argued that there was no mutual assent as to all material terms of the contract. The court cited § 2-204 to support its finding that a contract had been formed, emphasizing that:

> 1. Under § 2-204(1), a contract for the sale of goods may be made in *any manner sufficient to show agreement*, including conduct by both parties which recognizes the existence of a contract.
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> 2. Under § 2-204(2), a contract may be found *even though the moment of its making is undetermined.*
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> 3. Under § 2-204(3), even though *one or more terms are left open* a sales contract does not fail for indefiniteness if the parties have *intended* to make a contract and there is a reasonably certain basis for giving an appropriate remedy. The court also noted the gap-filler provisions upon which it could rely under Part 3 of Article 2. The gap fillers are summarized commencing at Section 3.2.4.1 below.
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> > The court noted that the *only* term generally required is a *quantity term*, citing Comment 1 of § 2-201 (statute of frauds).
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> > ***Warning:*** The Official Comment to § 2-204 states: "The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions." Although the UCC is more flexible, it still must be established that there was an intent to agree on the part of both parties.

3.2.4 If a seller agrees to sell a particular widget, and the buyer agrees to buy it, it looks like they made an agreement, but the terms are certainly indefinite. As discussed above,

the Code wants to facilitate the making of the agreement, and if the parties intended an agreement, it will attempt to supply the missing terms. The Official Comment to § 2-204 states:

> Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies, and the like.

Let's look at some of those "gap-fillers" or "default rules."

3.2.4.1. *Price.* In the absence of a stated price, the price is a reasonable price. The usual measure of a reasonable price is some objective source such as the seller's catalog or the market price. If the price is to be set by one of the parties, then that party is constrained by "good faith" as discussed in Chapter 1.

3.2.4.2. *Quantity.* Section § 2-204(3) states that a contract does not fail for indefiniteness if "there is a reasonably certain basis for giving an appropriate remedy." Failure to state a quantity can be fatal because without a quantity, it is difficult to determine the remedy. For example, if I sue you for your failure to deliver "widgets," how many did you promise me? Failure to state a quantity is not fatal, however, if there is a reasonable basis for supplying the quantity term. It might be supplied by course of dealing. If each month a law firm has purchased 10 reams of paper from a seller and in April it orders "paper," the quantity can probably be supplied by the past measure. According to § 2-306, if the quantity is measured either by the output of the seller or the requirements of the buyer, that is sufficient to establish a quantity. The amount supplied or demanded is constrained by good faith and by prior output or requirements.

3.2.4.3. *Delivery.* Section 2-307 provides the default rule that all the goods ordered must be tendered in a single delivery. If the parties contract around that rule, they have created an "installment contract" under § 2-612. According to § 2-308, in the absence of a specified place for delivery, the place of delivery is at the seller's place of business or residence if the seller does not have a place of business. As we will see, this concept becomes important when we discuss delivery terms in Chapter 10. The starting point is that the seller has no obligation to deliver the goods to the buyer.

3.2.4.4. *Time.* It will not surprise you that § 2-309 provides that when the contract does not specify a time, the default rule is a reasonable time.

3.2.4.5. *Payment.* Sections 2-307 and 2-310 provide that payment is due on tender of delivery. According to § 2-511, payment must be made in the manner current in the ordinary course of business. So if it is customary to pay by check, the seller must accept a

check. However, if the seller demands legal tender, the seller must give the buyer an extension of time to come up with the cash.

3.2.4.6. *Quality*. The quality of the goods promised by the seller is a matter of warranty law, which is discussed in Chapters 6-8.

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3.3. Offer and Acceptance. The UCC has not done away with the concepts of offer and acceptance. Although not expressly stated in such terms in § 2-204, both must still be present in order to form a contract under the UCC. We turn to the common law for basic principles of offer and acceptance, except to the extent they are revised by the UCC (which modifications we'll discuss in a moment). See § 1-103(b).

3.3.1. An "offer" is defined by *Restatement (Second) of Contracts* § 24 (1981) as "the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it." A "bargain" is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances. Id., § 3.

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3.3.2. At common law an offer can be revoked (that is, taken back) at any time prior to acceptance, unless consideration is paid to hold the offer open (referred to as an option contract). According to *Restatement (Second) of Contracts* § 36 (1981), in addition to revocation, the power of an offeree to accept is terminated by:

- Rejection or counter-offer by the offeree;
- Lapse of time; or
- Death or incapacity of the offeror or offeree.

3.3.3. **Firm Offers.** Section 2-205 alters the common law rule on revocation of an offer. Under common law, an offeror can withdraw an offer at any time prior to acceptance, *unless* the offeror has specifically agreed to hold the offer open, which agreement must be supported by *additional consideration***,** resulting in an option contract. See *Restatement (Second) of Contracts* § 25 (1981). For example, if on March 1 Gabe offers to sell his house to Dell for $100,000, offer open until April 1, he can withdraw his offer at any time prior to acceptance *unless* Dell pays consideration to Gabe for the promise to hold the offer open until April 1.

3.3.3.1. Take a look at § 2-205, which provides that an offer will be irrevocable, or firm, *without payment of any additional consideration* (*i.e.*, a departure from common law). The

provision probably reflects prevailing commercial practice. A firm offer is irrevocable under 2-205 only if it meets several requirements:

- the offeror must be a *merchant*;
- there must be a *writing signed* by the merchant offering to hold the offer open;
- the period of irrevocability must be for a *reasonable time*, which *cannot exceed three months* (and if longer than three months, the firm offer is enforceable up to three months but not beyond); and
- if the writing containing the firm offer is provided by the offeree, the firm offer portion of the writing must be separately signed by the offeror.

This fourth requirement is a good example of "reasonable expectations," a concept found frequently in the Code, though that name for it is never used. The concept recognizes the reality that the parties do not read their contracts carefully, and puts the burden on the party offering an unusual or unexpected term to reasonably call it to the attention of the other party.

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3.3.3.2. If consideration is paid by the offeree to the offeror to hold the offer open, the terms of § 2-205 do not apply. Read the last two sentences of Comment 3 to § 2-205.

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3.3.4. Once an offer is made, a contract is formed when the offer is accepted. Acceptance is the manifestation by the offeree of assent to the terms of the offer. *Restatement (Second) of Contracts* § 50. In other words, if the offeree does not clearly express assent to the terms that have been offered, there is no acceptance.

3.3.4.1. Under the common law, if an expression of "acceptance" contains any differing terms or additional terms than those contained in the original offer, this is a "counter-offer," and not an acceptance. Example: Sue offers to sell John her car for $10,000. John replies that he'll accept her offer, provided that she throws in a new set of tires. At common law, this is not an acceptance, but a counter-offer.

3.3.5. The UCC has modified the common law rule regarding "mirror acceptance," most notably under § 2-207, commonly referred to as the "battle of the forms." But let's start with § 2-206. We will dedicate Chapter 4 to the intricacies of § 2-207.

3.3.5.1. As the common law developed, there was a departure from the mirror image rule regarding the *manner* of acceptance. Today, most jurisdictions allow acceptance in any reasonable manner and by any reasonable medium *unless* the offeror prescribes a

specific manner or medium of acceptance. ***Note***: At common law, the offeror is still master of the offer, and can still insist on a specific manner or medium of acceptance.

3.3.5.2. Consistent with the development under common law, § 2-206(1)(a) allows an offeree to accept "in *any manner* and *by any medium reasonable* in the circumstances," *unless* otherwise unambiguously indicated by the language or circumstances.

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3.3.5.3. Section 2-206(1)(b) provides that if an offer to buy goods seeks "prompt or current shipment," the seller can accept by *either* a prompt promise to ship or by prompt performance. In other words, a reference to a prompt shipment is not to be construed as limiting the manner of acceptance to shipment, but also allows acceptance by promise.

3.3.5.4. Under § 2-206(1)(b), if there is an offer to buy goods for prompt or current shipment, and a seller responds by promptly sending a shipment, *but* the shipment is *non-conforming*, the shipment will nonetheless operate as an acceptance even though it does not mirror the terms of the offer. In other words, the seller accepts and breaches at the same time. However, if the seller does not want to breach, it can notify the buyer that the shipment is only an accommodation, in which event it becomes a counter-offer that the buyer can accept or reject.

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3.3.6. Under § 2-206(2), if an offeree accepts by beginning performance, and performance is a reasonable mode of acceptance, the offeree must also provide notice within a reasonable time of beginning performance. Failure to do so will allow the offeror to treat the offer as having lapsed before acceptance. Read Comment 3.