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THE UNIFORM COMMERCIAL CODE AND THE NORTH DAKOTA FARMER

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THE UNIFORM COMMERCIAL CODE AND THE NORTH DAKOTA FARMER

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Jerel Schimmelpfennig, Jerome E. Johnson, and Owen Anderson*

The Uniform Commercial Code (UCC) was adopted by the North Dakota Legislature to simplify and modernize the laws governing commercial transactions. The UCC has been adopted in most states so commercial law in the United States is fairly uniform.

An important principle of the UCC is that parties are free to create their own agreement and to establish the standards by which the performance of their respective obligations is to be measured. In the absence of a detailed private agreement, however, the UCC provides standards for carrying out the general agreement of the parties. This report discusses, without covering every detail, the UCC provisions relating to sales and secured transactions that are most important in day-to-day commercial activities of farmers.

SALES

Provisions of the UCC affect farmers when buying and selling materials and selling products from their farm or ranch operations. Sales transactions covered by the UCC are those where "goods" are being bought and sold. "Goods" includes growing crops, unborn young of animals, and such things as timber, minerals, or a structure to be removed from realty by the seller.

The UCC distinguishes between a merchant and a nonmerchant by imposing more responsibility upon merchants. A merchant is one who deals in a certain kind of goods or who, by his occupation, is deemed to have a knowledge or skill peculiar to the goods involved in the transaction. As a merchant a person could be liable for certain acts which a nonmerchant may do without liability. For example, a warranty of merchantability (discussed below) is implicit in a contract of sale only where the seller is a certain type of merchant. A merchant buyer who rightfully rejects goods as not conforming to the contract has a duty to make reasonable efforts to sell the goods for the seller if the goods are perishable or threaten to decline in value and if the seller has no agent. In contrast, a nonmerchant buyer need only hold and reasonably care for such goods for a sufficient time to allow the seller to remove them.

North Dakota courts have yet to decide if a farmer is a merchant. Courts in some other states have imposed the duties of a merchant upon a farmer when he is selling crops or livestock he has grown or raised. Courts, in deciding if a farmer is a merchant, look at the size of the transaction, frequency and length of time a farmer has engaged in selling the goods involved; whether the goods sold are the farmer's principal crop; and the farmer's familiarity with the market in which the goods were sold. Because of the factors used to determine merchant status, a farmer might be a merchant in one instance but not a merchant in another. Because a court may decide that a

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*Schimmelpfennig was a former student researcher on the joint Agricultural Law/Economics Research Program, Johnson is Professor of Agricultural Economics and Anderson is Professor of Law.

farmer is a merchant after a transaction has failed and the other party has sued, a farmer should be aware of UCC provisions relating to buying and selling farm goods.

CREATING CONTRACTS

The Offer.

The UCC lets parties create a contract in any manner that shows they intend to reach an agreement. The agreement can be explicitly stated in their language. An agreement also can be implied from their previous course of dealing, course of performance or usage of trade, or even from their conduct which recognizes the existance of a contract. Usually a contract arises from an offer from one person which is accepted by another for the present or future sale of goods.

A party who is a merchant that makes an offer to buy or sell goods and promises in writing that he will hold the offer open gives an offer that is binding on him for the stated period. The offer will be binding on him for a reasonable time if no period is stated, but not exceeding three months. For example, on June 1 a farmer offers, in writing, to sell a carload of seed potatoes for $2.00 a hundredweight and promises to keep the offer open until June 10. He cannot sell those potatoes to anyone else nor demand a higher price during that period even if the market price should rise. If he does sell to another he will be subject to a suit by the buyer for breach of contract.

Accepting the Offer

Acceptance of an offer may be in any reasonable manner unless the offeror specifies the manner for its acceptance. For example, acceptance may be by mail or telephone. However, if an offer to buy requires prompt or current shipment the seller may accept by either shipping the goods or promising to ship promptly. Acceptance by shipping should be followed by notice to the buyer of the shipment. An acceptance which states terms in addition to or different from the offer is effective as an acceptance and a contract is created. If one party is not a merchant the additional terms are treated as a proposal for addition to the contract. If both parties are merchants the additional terms become part of the contract unless: (1) the offer expressly limits acceptance to the terms of the offer; (2) the additional terms materially alter the contract; or (3) the party who receives the acceptance notifies the other party that he objects to the additional terms. Even if the writing between the parties does not establish a contract, the conduct between them may be sufficient to establish the existence of a contract.

Writing Required

Enforcement of a contract for the sale of "goods" that have a value of $500 or more requires that the contract: (1) be in writing, (2) be signed by the party against whom enforcement is sought, and (3) state a quantity. However, a contract which does not meet these requirements is still enforceable if one of the following occur:

1. if payment has been presented and accepted;
2. if the goods have been received and accepted;
3. if the party against whom enforcement is sought admits in a legal proceeding that a contract existed;
4. if the goods are to be specially manufactured for the buyer by the seller, they are not

suitable for sale in the seller's ordinary course of business, and the seller has substantial progress in their manufacture or procurement;

5. if one party has through fraud, misrepresentation, or conduct induced another to believe that certain facts exist and the other person relies to his detriment upon the purported facts; or

6. if a person promises another something which should reasonably induce action or forebearance and the other accepts, the promise is binding even if not in writing.

An oral contract over $500 in value between merchants is enforceable when a confirmation of the contract is sent by one party to the other and the other does not object in writing within 10 days of receiving confirmation.

TERMS OF THE CONTRACT

Quantity. Parties intending to have a binding contract must at least agree upon the quantity of goods to be bought and sold, even if other contract terms have beem omitted. Failure to state one or more terms does not invalidate the contract if the parties intended to contract and there is any reasonably certain basis for a court to properly infer the missing terms.

A provision requiring the quantity to be measured by the "output" of the seller or the "requirements" of the buyer is sufficient to satisfy the statutory requirements. Here "good faith" or honesty-in-fact sets the limitations upon what the parties can demand.

Price. A valid contract can be created even though the parties do not set the price. The price is a "reasonable price" as of the time of delivery, as determined by the court, if:

1. nothing is said as to price;

2. the price was left to be agreed on in the future and the parties fail to agree on the price; or

3. the price is to be fixed by some standard, such as the market price, at a certain time, or by some third person and for some reason the price is not so fixed.

For example, a farmer may wish to buy 100 bushels of a new barley variety that he thinks will be scarce for seed. He contracts in February with a dealer for 100 bushels of seed to be delivered April 1, and they agree to later set the price. If by April 1 they have failed to agree on the price, a court can determine a reasonable price.

If the parties agree that the price should be set by the dealer on or before April 1, the price must be set in good faith. Should the dealer through his own fault fail to set the price, the farmer may treat the contract as cancelled or set a reasonable price himself.

DELIVERY AND PAYMENT

Normal contracts for the sale of goods place the seller under an obligation to transfer and deliver them to the buyer. Upon tender of delivery the buyer has the duty to accept them and to pay for them. But the terms of the contract may change the seller's obligation to act first. For example, in a

contract where the seller is to deliver potatoes as needed by the buyer and the buyer is to furnish vehicles for loading and transporting the potatoes, the seller has no obligation to deliver until the buyer demands delivery.

Delivery is presumed to be at the seller's place of business if the parties do not agree on the place. If the goods are located somewhere other than the seller's place of business at contract time and both parties know where the goods are, that is the delivery place. This example means that if the parties did not agree to the place of delivery and both parties know that the potatoes are in a warehouse which is not the seller's place of business, the delivery place is where the potatoes are stored.

Failure to state the time for delivery of goods does not invalidate a sales contract. Contracts that do not state the time for delivery require that the goods be delivered within a reasonable time. Just what is a reasonable time depends on what is acceptable commercial conduct given the nature, purpose, and circumstances of the contract, the course of dealing between the parties, and the usage in trade. If the delivery time is not specified, it must be within a reasonable time, and neither party may cancel the contract for delay in performance without reasonable notice to the other based on the parties' course of dealing and general usage in trade. For example, a farmer contracts for seed and no delivery time is stated in the contract. If the farmer contracts with the same seed dealer every year for seed for spring planting the dealer is expected to deliver the seed in time for planting.

Time for payment, if not specified, is at the time when and place where the goods are delivered. A seller who is authorized to ship the goods can ship them under reservation and deliver the documents of title, such as bills of lading, to the buyer in return for payment. However, the buyer can inspect the goods after they arrive and before he pays, unless such inspection is inconsistent with the terms of the contract. These UCC provisions protect both the buyer and the seller, as the buyer is allowed to inspect the goods before he pays while the seller does not have to give up title to the goods until they are paid for.

The UCC not only lets the parties create their own contract, and include or exclude any provisions upon which they agree, but may supplement a contract that has terms or particulars of performance open. The UCC recognizes that parties enter into contracts so that each will get the performance wanted and protects these contracts by assuring that they will not fail because they would have been too indefinite under the older law.

Suppose a farmer contracts to sell his future crops but crop failure prevents his performance. Has he breached his contract duty? Probably not if the crop failure was not contemplated by the parties in writing contract. A partial failure of the crop that he has contracted to sell requires that he must allocate what production he has to those with whom he has contracted. He also must notify the buyer that there will be either a partial delivery or no delivery at all.

WARRANTIES

A contract for the sale of goods provides for certain warranties unless they are excluded or modified by the contract itself.

There are three types of warranties under the UCC: warranties of title, express warranties, and implied warranties.

Warranties of Title. The seller in all sale contracts first warrants that the title to the goods sold is good and that his transfer of them is right and proper. Second, he warrants that the goods when delivered will be free from any liens or mortgages of which the buyer had no actual knowledge when contracted. This warranty protects the buyer from a lawsuit by a third party claiming title to the goods after they have been transferred to the buyer.

A warranty of title can be excluded or modified if the parties so agree by specific language in the contract. Further, it will not be applicable if there are circumstances that alert the buyer that the seller does not claim title in himself or that he is selling only such limited right as he has. Examples of things that should alert the buyer are a sale by a sheriff under a sheriff's deed or a sale by an executor of a will. Here the seller does not claim title in himself and the transfer might later be set aside.

Express Warranties. Express warranties arise from the "dickering" of the parties. Ordinarily, express warranties with respect to the goods may be created by the seller in one of three ways.

The first is where the seller affirms or promises something to the buyer about the goods, and that is the basis of the bargain. The warranty is that the goods will conform to the affirmation or promise. For example, if a farmer selling livestock affirms or promises something which relates to the animals, he creates an express warranty that the animals will conform to the affirmation or promise.

The second is where a description of the goods, whether by words, specification or past deliveries, is the basis of the bargain; there is an express warranty that the goods conform to the description. A farmer creates an express warranty when he gives a description of the animals which is a part of the basis of the bargain. He warrants that the animals conform to the description.

The third is where a sample or model is the basis of the bargain. The warranty is that the goods conform to the sample or model. A farmer creates an express warranty when he asserts or promises that a grain sample is representative of all grain he is selling.

An express warranty arises when goods are sold even if the seller did not use the words "warrant" or "guarantee" or even intend to create a warranty. It is not even necessary that the buyer rely on the seller's statement. However, mere affirmations of value by a seller or his opinion or recommendation in regard to the goods (his sales pitch) do not create a warranty. The time when the affirmation or description is given is not important if it becomes a part of the contract. Whether express warranties have been created can be best determined by asking, "What in essence has the seller agreed to sell?"

Implied Warranties. In addition to express warranties, certain implied warranties may arise in a contract for sale. There are two kinds of implied warranties under the UCC: (1) merchantability and (2) fitness for a particular purpose.

Implied Warranty of Merchantability. The seller who is a merchant gives a warranty that his goods are merchantable, which is implied in a contract for sale, and means that the goods are generally acceptable in the trade. The warranty is implied in a contract for sale if there is no attempt to exclude or modify it or if the exclusion or modification is voided by court action.

Merchantable goods must be at least such as:

1. pass without objection in the trade under the contract description;

2. if they are fungible goods* they are of fair average quality within the description;

3. are fit for the ordinary purpose for which such goods are sold;

4. run, within variations permitted by the agreement, of even kind, quality, or quantity within each unit and among all kinds involved;

5. are packaged as the agreement requires; and

6. conform to the promises or affirmation of fact put on the container.

The first and second provisions are the most important for persons in agriculture. "Fair average" is the most appropriate term to use when dealing with agricultural bulk products and means goods in the medium quality range within the description so that they can pass in the trade without objection. A grower who sells barley seed which is not clean when it arrives breaks the implied warranty of merchantability.

Implied warranties may arise from course of dealing or use of the trade, unless they are excluded or modified by the contract. A typical situation would be in the sale of a registered bull. Here the seller would be under an obligation to provide pedigree papers that give evidence the animal conforms to the contract specifications.

Implied Warranty of Fitness for A Particular Purpose. This warranty arises when the seller knows that the buyer intends to use the goods for a particular purpose and that the buyer is relying on the seller's skill or judgment to select or furnish goods which are suitable for that purpose. The seller impliedly warrants that the goods shall be fit for the buyer's use unless excluded or modified.

For example, a manufacturer orders pipe to make harrow attachments and relies upon the supplier's skill or judgment to furnish suitable goods. The supplier knows the manufacturer's particular use of the pipe. The supplier will be liable if the pipe is not strong enough to meet the manufacturer's need because he will have impliedly warranted the fitness of the pipe for a particular purpose.

Whether or not such a warranty arises is determined by the circumstances at the time the contract of sale is agreed on. Two conditions must exist: first, the buyer's proposed use must be peculiar to the nature of his business as opposed to the ordinary purpose for which such a product is used; second, the seller must know the

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*One unit is the same as any other unit, such as a part of a crop in storage.

purpose for which it is to be used and that the buyer is relying on the seller's judgment.

Excluding and Modifying Warranties. What is the effect of wording in a sales contract that excludes "all warranties, express or implied?" Express warranties may not be excluded if the exclusion language is inconsistent with other language in the contract that would ordinarily create an express warranty.

The implied warranty of merchantability may be excluded or modified if merchantability is specifically mentioned and in case of a writing it must be conspicuous. The only way the implied warranty of fitness may be excluded or modified is through a written statement that is conspicuous. An exclusion in fine print may not be effective. A statement that "there are no warranties which extend beyond those described" is sufficient to exclude a warranty of fitness.

Implied warranties also may be excluded by such words as "as is" or "with all faults" or others that call to the buyer's attention that the seller does not intend any implied warranties. But the words are ineffective if the buyer is not given an opportunity to see or read the exclusions. For example, a farmer hired a spraying service to apply a herbicide on his wheat crop and the crop was damaged as a result. The herbicide container was labeled with statements to exclude an implied warranty of fitness for use. Since the farmer was not shown the label, the warranty exclusions had no effect.

An inspection of the goods as fully as the buyer desires or a refusal to examine them replaces the implied warranty that the goods are not defective if an examination would have revealed the defects. An implied warranty also can be excluded or modified by course of dealing, course of performance, or usage of trade. However, when cattle, hogs, sheep, or horses are sold there is no implied warranty that they are free from sickness or disease if the seller can show that he has complied with all state and federal animal health regulations.

There exists additional protection for persons who purchase for their use a tractor, a gas engine, or harvesting machinery. Attempts to exclude warranties from these equipment will fail. A provision separate from the UCC makes it impossible to include a complete disclaimer in a sales agreement for tractors and harvesting machinery. Purchasers of these equipment are given super protection while implement sellers are under a great burden.

PERFORMANCE OR NONPERFORMANCE OF THE CONTRACT

The seller's primary duty is to deliver the goods and the buyer's primary duty is to accept and pay for them. This section discusses the manner in which the seller and the buyer carry out their mutual duties and how they are to act if there is nonperformance.

Delivery by Seller. The seller is under the first duty to "tender" delivery of the goods, since the buyer's duty to accept the goods and to pay for them does not come into being until they are tendered. Tender requires that the seller hold the goods for the buyer and that he give the buyer any notice that is necessary to enable him to take delivery. The place, manner, and time for delivery can be agreed by the parties, but the tender must be at a reasonable hour and the goods must be available long enough for

the buyer to take possession of them.

Cure. The contract is not necessarily broken under the UCC when a seller delivers goods that do not conform to contract specifications. For example, suppose a seed grower contracts to deliver 100 bushels of seed on May 1. He delivers some seed to the buyer on April 15, but the buyer rejects the delivery because it is not the proper variety. Rather than treating the contract as broken the UCC provides that since the time for performance (May 1) has not yet expired, the seller may notify the buyer of his intention to cure; that is, to deliver conforming seed to the buyer by May 1. The seller can cure even though he has taken back the nonconforming seed and refunded the purchase price.

Payment. Payment is due when the goods are tendered unless the parties agree otherwise. Payment may be by check or any other means used in the ordinary course of business unless the seller demands payment in cash. Payment by check is only conditional and is defeated if the check is dishonored.

A problem that develops with respect to payment concerns inspection. The buyer has a right before accepting and paying for the goods to inspect them at his own expense unless the parties agree otherwise. The buyer can inspect goods shipped by the seller after their arrival.

There are times, however, when the buyer cannot inspect the goods before he pays for them. One is where the contract requires payment before inspection. Another is where the contract calls for cash on delivery. Third is where the contract provides for payment against documents of title, unless the payment is due only after inspection. These payments do not constitute an acceptance of goods or impair the buyer's remedies if the goods are nonconforming.

Acceptance. Acceptance occurs when:

1. the buyer, after an opportunity to inspect the goods, signifies that they conform, or that he will take them despite their nonconformity; or,

2. the buyer fails to effectively reject them within a reasonable time or fails to notify the seller; or,

3. the buyer acts inconsistently with the seller's ownership.

Once accepted, the buyer must pay for those goods. Suppose, however, that in the preceding example the buyer accepts the seed after delivery because the nonconforming variety of seed is in the middle of the load and he did not spot it in his initial inspection. What can he do? Once he discovers the nonconforming variety he must notify the seller of the breach within a reasonable time. Then he may revoke his acceptance with respect to all of the seed or as to the nonconforming variety. Then he has the same rights and duties as if he had rejected the goods initially.

A buyer can revoke his acceptance in two situations. The first is where he has accepted the goods on the reasonable assumption that the defect would be cured and it has not been. The second is where he has accepted the goods without discovering the defect because of the difficulty of discovery. In either case the buyer must do so within a reasonable time and notify the seller.

Buyer's Rights on Improper Delivery (Rejection). Two situations exist when a buyer may be able to reject the goods. One is when the entire order of goods is received in one shipment. Suppose that a seed grower agrees to sell 100 bushels of Olaf wheat. When the seed is delivered to the buyer, he finds that there are 75 bushels of the Olaf variety and 25 bushels of the Len variety. What can and should the buyer do? When the tender of delivery fails, the buyer may:

1. reject the whole lot;
2. accept the whole lot; or,
3. accept any commercial unit (the 75 bushels of Olaf) and reject the rest, provided that the price can be apportioned between the goods accepted and those rejected.

The buyer who decides to reject the goods must do so within a reasonable time and must so notify the seller. The buyer may not exercise any ownership with respect to the goods after the rejection. If the buyer has taken possession of the goods before he rejects them, he must hold them with care for a time that will be sufficient for the seller to remove them. If the buyer is a merchant and the seller does not have an agent nearby, the buyer has a duty to follow any reasonable instructions from the seller which involve the goods. If the goods are perishable or threaten to decline in value quickly, the merchant buyer must make reasonable efforts to sell them for the seller.

The buyer's notice of rejection must state the defect in the goods. The buyer cannot rely on an unstated defect if the seller would have had time to "cure" or if the seller has requested a final written statement of all defects. After rejection, the buyer may still pursue any remedy of an injured buyer.

The second situation is where the goods are to be delivered in installments. This can arise where a seed grower contracts to sell a producer two or more shipments of seed. The buyer may reject any installment which does not conform to the contract if the defect substantially impairs the value of the installment and cannot be cured. Thus a buyer could reject the first load of seed that did not conform. When an installment does not conform to the contract and therefore substantially impairs the value of the entire contract, the entire contract is breached. Accepting delivery of the first load, even though it does not conform to the contract and substantially impairs the value of the entire contract, prevents the buyer from rejecting a later load based upon the defect in the first. The buyer will be held to reinstate the contract if he accepts a nonconforming installment without notifying the seller that the contract has been cancelled due to defect in an installment which impairs the value of the entire contract.

Adequate Assurance of Performance. Should the ability or willingness of either party to perform his part of the bargain become doubtful after a contract has been agreed on, the other party may demand in writing an adequate assurance of performance. He may suspend his performance until he receives such assurance. Failure to respond to a demand within 30 days will result in a repudiation of the contract. A seller might wish to demand such an assurance where, after the contract is signed, he believes that the buyer will be unable to pay. A buyer might demand assurance when he believes that the

seller's ability to deliver has become uncertain. This assurance protects one party from performing when there is a likelihood that the other cannot or will not perform.

Anticipatory Breach. An anticipatory breach occurs when one party repudiates a contract before performance is due. Suppose a breeder contracts with a rancher for the sale of 10 head of foundation stock to be delivered on November 1. On October 15 the breeder notifies the buyer that he does not intend to deliver the stock. Here the buyer may treat the contract as broken and pursue his remedies provided he moves in good faith. Or he may notify the breeder that he intends to wait until November 1 for performance; even though he so notifies the breeder, the UCC still allows the buyer to seek remedies for breach of contract.

The breeder may, until his performance is due, retract his repudiation in any manner that clearly shows the buyer that he intends to perform, unless the buyer has cancelled the contract or has in any other way materially changed his position, such as by contracting with another breeder for the stock. After such a change in position the breeder may not retract his repudiation.

REMEDIES

The UCC provides remedies to a buyer or seller that can be liberally administered and enforced in the courts so that an aggrieved party may be put in as good a position as if the other party had fully performed. The parties can contract to modify the remedies provided in the UCC or to substitute other remedies, or to contract for liquidated damages.

Liquidated damages is a specific sum of money stated in the contract to be paid by the party who breaks the contract. Damages must be reasonably related to the losses that would likely come from breaking the contract; if unreasonably large or small a court will not enforce payment.

The UCC remedies are generally used when the parties have no remedies in their contract or if their remedies fail.

The Seller's Remedies. When a buyer wrongfully rejects goods, repudiates the contract, or fails to make a payment due, the seller can:

1. stop delivery of goods;
2. resell the goods and recover damages;
3. recover damages for non-acceptance;
4. recover the price;
5. cancel.

The seller can use one or more of these remedies.

Stopping Delivery. When a seller has shipped goods on a common carrier, he may stop delivery of carload, truckload, or larger shipments if the buyer has repudiated the contract or failed to make a payment due before delivery or if any other reason justifies withholding the goods. A seller may stop the delivery:

1. any time up until the goods have been received by the buyer; or
2. until someone holding the goods for the buyer notifies the buyer that he has them; or
3. until a negotiable bill of lading has been given to the buyer; or

4. until the goods have been reshipped by the buyer.

The seller stops delivery by notifying the carrier in time to prevent the delivery. However, if a negotiable bill of lading has been issued, the carrier need not stop the delivery until the document is surrendered. The carrier only has to obey an order from the person who has consigned the goods if they were shipped under a nonnegotiable bill of lading.

Subject to the above rules, when a seller discovers that a buyer is insolvent he may refuse delivery except for cash, regardless of size of shipment. His right to demand cash includes payment for all goods previously delivered under the contract. A special rule applies to a seller who is a producer of agricultural products, where he can reclaim products within 10 days after the buyer received them.

Seller's Right to Resell Goods. The seller can resell goods when a buyer has broken the contract and goods have been identified as referring to the contract. The seller can recover from the buyer the difference between the price he sells the goods for and the contract price plus expenses connected with their resale.

The seller may resell the goods either privately or at a public sale, such as an auction. He must notify the buyer if he intends to resell them privately and give the time and place if he plans to sell them publicly.

Grain in storage is considered identified to the contract and the seller may resell it. Identification of crops to a contract occurs when crops are planted or if the crop is already in the ground and to be harvested within 12 months of the contract date.

Seller's Damages for Nonacceptance or Repudiation by the Buyer. What might happen when a buyer does not accept goods that conform to the contract or repudiates the contract before the time for performance is due? Here the seller can recover as damages the difference between the market price at the time and place where the goods are tendered and the unpaid contract price. If this measure of damages does not put the seller in as good a position as performance of the contract would, then the measure of damages is the profit the seller would have earned on the sale.

Seller's Action to Recover Price. There are two situations in which a seller can recover the price from the buyer. One is when the buyer has failed to pay after accepting the goods. The other is when the buyer has failed to pay for goods that the seller has identified (set aside) for the sale, and, after the buyer's failure to pay, the seller is unable to sell the goods to anyone else. This might occur when the seller has made the item specially for the buyer, such as a silage mixed to the buyer's peculiar needs.

Whenever a seller sues the buyer for payment, he must either hold the goods for the buyer or, if he can, resell them and credit that amount to the buyer's account.

Incidental Damages. The seller can recover all incidental damages caused by a breach of the contract by the buyer, in addition to pursuing one of the previous remedies. Incidental damages include reasonable expenses incurred in stopping delivery, transporting the goods, or in the care and custody of the goods in connection with return or resale of the goods after the contract was broken.

The Buyer's Remedies. The buyer may cancel the contract if the seller fails to deliver the goods or repudiates the contract, or if the buyer properly rejects the goods or accepts the goods and then revokes his acceptance. A buyer can revoke his acceptance of goods if he does so within a reasonable time after he discovers that the goods do not conform to the contract. The buyer, in any event, may recover what he has paid and either purchase the goods from another source ("cover") and recover any extra cost or recover damages for nondelivery. The buyer has additional remedies in some cases where the seller fails to deliver the goods or repudiates the contract before time for performance. One situation is where the seller is so low on cash or other assets that the buyer could not recover any money from him. In this case, the buyer would be able to recover goods if the seller has identified them as the ones that would be used in the contract. Another situation is where the goods sold are unique and the buyer cannot get similar goods anywhere else. A court could order the seller to deliver those goods to the buyer.

Cover. The buyer may "cover" when a seller fails to deliver the goods or repudiates the contract. This means the buyer can purchase substitute goods. He must do so in good faith and without unreasonable delay. The buyer can recover the difference between the contract price and the cost of substituted goods after buying them. If a buyer fails to "cover" or "covers" improperly by waiting an unreasonable length of time or buys in bad faith, he may still be entitled to some relief.

Buyer's Damages for Nondelivery or Repudiation. A buyer who did not accept the goods and has not covered can recover as damages the difference between the contact price and the market price at the time when he learned of the breach. The market price is set as of the place where the goods were to be delivered. But the market price is set at the place of arrival where the goods were delivered and rejected or where the buyer revoked his acceptance.

Buyer's Damages for Accepted Goods. A buyer who accepts the goods and then finds that some warranty has been broken and the time to revoke his acceptance has passed may recover damages for breach of warranty. He must notify the seller of defects within a reasonable time or he cannot recover. Damages for breach of warranty are the difference between the value of the defective goods and the value that they would have had if they had been as warranted. Damages are set as of the time and place where the goods were accepted. However, if there has been damage of a different amount due to special circumstances, that amount may be recovered. A buyer who has not paid the full contract price may deduct the damages he has sustained due to the breach from the amount still due. He must notify the seller of his intention to do so.

Incidental and Consequential Damages. A buyer may, in addition to pursuing one of the previous remedies, recover other damages caused by the breach. He can recover incidental damages resulting from the breach. These include reasonable expenses which the buyer incurred in inspecting and handling goods rightfully rejected, obtaining cover, and any other reasonable expense incident to his delay or breach. He also can recover consequential damages resulting from general or particular requirements of his that the seller had reason to know of and for injuries to people

or property caused by the breach of warranty.

SECURED TRANSACTIONS

This section discusses financing of transactions that come under the UCC, called "secured transactions." A secured transaction occurs when the secured party obtains a security interest in collateral by entering into a security agreement with the debtor that creates or provides for such an interest.

Examples of two simple secured transactions will help explain it. First, suppose that you borrow $5,000 from your banker and you agree that your automobile will be used as security for the loan. Your agreement is that if you default on repayment, the bank may take your car in satisfaction of the debt. Second, suppose that you buy a tractor from an implement dealer and will not pay in full now. You agree that he will have such an interest in the tractor that if you default in the payments he may repossess it.

The lender or seller in each example is the "secured party," also called a creditor. The interest that he has in the car or tractor is a "security interest." The car or tractor--personal property--is the "collateral" given to secure the agreement. The borrower or buyer is the "debtor." The paper that is signed containing the names of the parties, the price, and all of the conditions of the agreement is the "security agreement."

Before the UCC became law, such transactions used various security devices, such as chattel mortgages, conditional sales contracts, trust receipts, factor's liens and assignments. Under the UCC, although the same papers and printed forms are used as before, all such papers are called "security agreements." Greater flexibility in financing transactions is now possible by tailoring agrements to fit the uniform set of UCC laws.

The UCC applies only to transactions which are intended to create a security interest in personal property and fixtures (personal property attached to the land). The real estate mortgage is not governed by the UCC. Prior North Dakota laws governing small loans, retail installment contracts and crop mortgages are still in effect and will prevail over the UCC if they conflict with the UCC.

A security agreement is not enforceable unless the collateral is in the possession of the secured party or the debtor has signed a written agreement which describes the collateral, the creditor has given the debtor value for his security interest, and the debtor has rights in the collateral.

Possession. The transaction is called a pledge when the secured party actually takes possession of the collateral until the debt is repaid. You have created a pledge of property if the bank takes actual possession of your car as collateral for your loan of $5,000. The property holder, the secured party, has the duty to use reasonable care while keeping the collateral and in preserving it. The cost of this care or preservation is chargeable to the debtor unless otherwise agreed. The risk of accidental loss or damage to the collateral is also borne by the debtor unless the security agreement specifically states otherwise.

Collateral may generate profits or increases in value, and here the secured party may retain the

profits or the increase as additional security. The money received must either be given to the debtor or credited to the security agreement to reduce the debt. The secured party must keep the collateral identifiable, but if the collateral is fungible goods it may be mixed with other similar goods.

Written Security Agreements. The collateral must be described in the security agreement that is signed by the debtor. A description of the land must be included if the security interest covers crops growing or to be grown.

Collateral. The term collateral is used to describe both tangible and intangible property subject to a security interest. This discussion will deal primarily with tangible collateral called goods.

Intangible collateral will be discussed only insofar as it affects typical farm transactions.

Tangible Collateral (or goods) can be one of four kinds: consumer goods, equipment, inventory, and farm products. The UCC categories are mutually exclusive so that a single piece of goods can be classified in only one category at any one moment. A refrigerator could not be both consumer goods and inventory at the same time. The category into which goods are placed will depend upon the purpose for which the owner holds them or how he uses them.

(1) Goods are consumer goods when they are used or bought for use primarily for personal, family or household purposes (a refrigerator in the home, for example). North Dakota provisions of the Small Loan Act and the Retail Installment Sales Act are still in effect and deal mainly with interest and finance charges. These laws contain some different procedures for foreclosing on collateral after default than the UCC and will prevail over the UCC in case of conflict. (2) Equipment is goods used or bought for use primarily in business, including farming (a tractor, for example). (3) Inventory goods are held ultimately for sale or lease in the ordinary course of business. A refrigerator while for sale in an appliance store would be inventory. (4) Goods are farm products if they are crops or livestock used or produced in farming operations or if they are products produced in an unmanufactured state (such as eggs or milk) and if the debtor possessing them is engaged in farming operations. The test used to determine whether goods are farm products or inventory of the farmer is whether or not the crop or livestock is subjected to a manufacturing operation. Livestock clearly can be a farm product but if the livestock farmer slaughters his stock, cuts and prepares the meat for market and offers it for sale, it would be inventory. This classification and reclassification of property can have an effect on the rights of a secured party with a security interest in the property. A security interest in farm products might not be cut off or defeated by someone who buys them from the farmer. A buyer of goods that constitute inventory in the ordinary course of business buying products from the farmer and without knowledge of the security interest could acquire rights superior to the secured party.

Intangible Collateral includes accounts, general intangibles, documents, instruments, and chattel paper. An account is any right to payment for goods sold or leased or for services rendered which is not evidenced by a written document. General intangibles include all personal property not

classified as goods, accounts, chattel paper, documents, instruments, and money. A document is a document of title. An instrument means a negotiable instrument or a security, such as a draft, check, certificate of deposit, or a note. Chattel paper is a writing which evidences a monetary obligation and a security interest in specific goods.

The UCC specifically provides that a security interest is still valid even if the debtor is allowed to use, commingle or dispose of part or all of the collateral. As in the case of grain stored in bins on the farm, the agreement could even allow the debtor to sell the collateral and use the proceeds without replacing the grain. The flexibility in this type of security agreement is evident, for the debtor may make full use of his property even while it is serving as security for a loan. Such a standard agreement also will often contain an after-acquired property clause, so property later acquired could replace the original collateral. Crops can be sold, herds expanded or animals replaced, or equipment repaired or replaced without hampering the rights of either party or requiring that the agreement be rewritten each time there is a change in the collateral. At the same time, this arrangement does justice to third parties dealing with the debtor since the lender's security interest can only be perfected by a public filing of a statement telling of the financing arrangements. All third parties are treated as having notice of the contents of the financing statement after it has become a matter of public record.

THE SECURITY INTEREST

Three requirements must be met to create an enforceable security interest. (1) There must be a written security agreement between the parties, or the collateral must be in the hands of the secured party according to the agreement; (2) value, such as a loan of money, must be given by the secured party. (3) The debtor must own, or at least have some rights in, the collateral. A security interest is said to "attach" to the collateral when these requirements are met, unless the parties agree otherwise.

The UCC allows property acquired after the secured transaction has been completed to be used as collateral for the transaction. Such a provision is called an after acquired property clause. It is also possible for the funds received by the borrower to be paid to him in installments spread over a period of time. When done this way one security agreement can be used to cover all the advances.

Perfecting the Security Interest. A lender, to protect himself when he lends money and creates a security interest in property, should "perfect" his security interest. Perfection exists when the lender is treated as having informed others that the property in question is subject to his security interest. This is necessary to prevent two lenders from relying upon the same property as collateral when the property is worth less than the combined security interests. The UCC provides two methods for perfecting; taking possession of the collateral or filing a financing statement.

Taking Possession of the Collateral. Third parties should realize that a creditor has some claim to the debtor's property if the creditor has the property in his own possession. When a third party, usually another lender, realizes that, he may want the borrower/debtor to furnish something else as

collateral. Perfection by possession works well only when the collateral is goods, instruments, documents, or chattel paper. It does not work as well with tangible collateral--consumer goods, equipment, farm products, and inventory--since the debtor often needs the use of these items, and it is usually inconvenient for the creditor to hold them. A farmer who uses his tractor as collateral for a loan to buy seed can not afford to give up possession of the tractor during the planting season. A creditor will usually perfect the security interest by filing a financing statement in an office of public record. This system has been used for years in North Dakota for recording real property deeds, mortgages and other documents, and for filing crop mortgages.

Filing the Financing Statement. The financing statement and the security agreement are normally separate documents with different purposes. The financing statement merely indicates that the creditor has a security interest in certain described collateral. The address of both parties must be listed, but only the borrower need sign it. The statement must have a description of the type or items of collateral and, if growing crops or fixtures are the collateral, a description of the real property is necessary. A copy of the security agreement, however, may serve as a financing statement if it meets these requirements.

The borrower usually prefers to use separate documents for the security agreement and the financing statement. The security agreement will contain a full detailed listing of the collateral and the details and terms of the transaction. The financing statement, however, might only state the collateral in general terms, such as "crops, livestock, and equipment." This method of using different documents permits more privacy in the transaction.

The financing statement is recorded in the register of deeds office in the county where the debtor lives when the collateral is equipment used in farming operations or farm products, or consumer goods, or accounts, or general intangibles arising from or relating to the sale of farm products by a farmer. If, however, the debtor is not a resident, the financing statement is filed where the goods are located; for example, if the debtor resided in Minnesota and the goods were located in Cavalier County, North Dakota, the financing statement should be filed in Cavalier County.

When the collateral is crops or fixtures, the statement is filed in the register of deeds office in the county where the land growing the crops or having the fixtures is located. Using the same example as above, if the crops were being grown in Cavalier County then that is where the financing statement should be filed.

The statement in all other cases is filed in the office of the North Dakota Secretary of State in the State Capitol (with the exception that a motor vehicle required to be registered must have the security interest noted on the document of title).

The original filing is still effective if the debtor's place of residence or place of business or the location of the collateral changes. For example, a North Dakota farmer might purchase cattle to fatten by borrowing money from a bank. The bank would take the cattle as collateral for the loan. The bank would have to file a security interest in the cattle, as farm products, with the register of

deeds in the county where the debtor resides. If the debtor/farmer either moved his residence or his place of business to Minnesota, the filing would still be effective; the same is true if the cattle were also moved.

Purchase Money Security Interests. A "purchase money" security interest is created by a person who: (1) sells the collateral to the debtor, or (2) advances funds which enable the debtor to buy the collateral from someone else. The tractor dealer who sells the tractor to the farmer and takes a note and security agreement is an example of the first situation. The second situation arises when a Production Credit Association lends money to a farmer to enable him to buy the tractor from an implement dealer and the association receives a security interest in the tractor.

A purchase money security interest in consumer goods (personal, family or household goods) is considered perfected even though not filed. This tech-nique permits perfection of a security interest without the cost and bother of filing when small purchases are involved and for items not regularly in the stream of commerce since their use is limited. However, filing is required for a fixture that is incorporated into a structure or if it is a motor vehicle that must be licensed.

Sales of the Collateral by the Borrower/Debtor. In most situations a person who purchases goods from a person who is in the business of selling them is not subject to a perfected security interest which the seller has created. The most important exception is that a person buying farm products from a person engaged in farming operations is subject to the security interest which the seller has created. For example, a farmer sells cattle produced in his farming operation to a buyer after he had granted a security interest in the cattle to a bank. The bank correctly perfected its security interest, so the buyer then takes the cattle subject to the bank's security interest. A person buying consumer goods from another owns them free of a security interest if he: buys them without knowledge of the security interest; gives something of value for them; uses them for his own personal, family, or household purposes; and the secured party has not filed a financing statement covering the goods.

PRIORITIES

A debtor often gives security interests in the same collateral to two or more creditors. The law then must decide which one has priority. The general rule is that the first claim will prevail. That is, if both creditors have perfected their security interests by filing financing statements the first one who filed has priority. If neither security interest has been perfected then the first one to attach has priority. A purchase money security interest, in collateral other than inventory, has priority over conflicting security interests if the purchase money security interest is perfected when the debtor receives possession of the collateral or within 10 days after.

A special situation exists where a creditor lends money to a farmer so that he may grow crops that are to be the collateral. If the lender perfects his security interest, he will be given priority even over a prior perfected security interest if: (1) the loan was signed not more than three months before the crops were planted; and (2) the earlier security interest

was to secure a debt that was due more than six months before planting time.

Protection of Buyers. Parties normally will specify in their agreement whether the debtor is authorized to sell or dispose of the collateral without permission of the secured party. This authorization lets the buyer of the collateral from the debtor take the property free and clear of the security interest. It also permits the debtor to transact his personal and business affairs freely while the secured party is still protected. Otherwise, a security interest continues in both the collateral, even after the debtor sells it, and in identifiable proceeds from the sale. This situation can result in two innocent parties--the perfected secured creditor and the buyer from the debtor--claiming the same thing, the collateral sold by the debtor. Ordinarily, where a debtor has sold the collateral and the perfected security holder has not authorized it, the perfected security holder usually prevails over the innocent buyer.

There are a few circumstances where the buyer has a better right to the collateral than the secured party. A secured party who has not perfected his security interest is subordinated to the person who purchased collateral. Also, the buyer of inventory from a dealer takes the merchandise free of even a perfected security interest. Here the important requirement is that the goods be purchased in the ordinary course of business from a dealer of those goods. It is reasonable to assume that a dealer selling his usual goods has a valid title to them. This rule allows a normal free flow of business. But this rule does not apply if (1) the buyer knew the sale was in violation of the security agreement or (2) the buyer purchased farm products directly from a farmer who had used the goods as collateral.

For example, suppose that an implement dealer has used his inventory of machinery as collateral for a loan from the bank and that the security interest has been perfected by filing a financing statement. A farmer who buys a machine from the dealer in the normal course of his business takes clear title, even if that farmer knew that the security interest existed. The same would be true even if the sale was unauthorized, unless the farmer knew that the sale was in violation of the provisions of the security agreement with the bank. It probably would be rare to find a dealer without authority to sell the collateral since such sales normally would be the method decided upon for repaying the debt. A farmer who is suspicious about the extent of the dealer's authority to sell the goods is the subject of the next example of a procedure for discovering any limitations on such authority.

A person buying farm products from a farmer does not take them free of a perfected security interest. For example, suppose that rancher Anderson uses his cows as collateral for a $10,000 bank loan. Suppose further that the financing statement is filed so that the security interest is perfected. Rancher Brown then buys 100 cows from Anderson, and he pays cash for them. Brown takes the cows subject to the bank's prior security interest, which can be foreclosed if Anderson defaults on his loan. Thus, Brown will want to protect himself before he buys. But checking the public records probably will only produce a financing statement that the bank has security interest in "livestock." The 100 cows that Brown wishes to purchase may not be included. His best

course of action is to simply ask his seller to have any of the seller's creditors produce a statement as to their security interest in the 100 cows. The UCC provides that if rancher Anderson asks his creditor (here the bank) for such a statement, the creditor must give it within two weeks. A wait of two weeks will give Brown full information as to the nature of the security interest and whether it affects these 100 cows. If time is important, as it would be in a changing market, most creditors would cooperate immediately.

Clear title passes to Brown if the creditor fails to reply or the reply states that there is no claimed security interest in these cows. If a creditor does claim an interest, Brown should not buy the cows without requiring rancher Anderson to obtain a release of these cows from the collateral listing, unless absolutely confident that Anderson will not default on his loan.

Default by the Borrower. The UCC does not state what acts or omissions constitute default. The parties to the agreement should specify such conditions and put it in the written security agreement.

The purpose of using collateral in a secured transaction is to guard against default or, if default occurs, to insure payment. A secured party may take possession of the collateral upon default. This can be done without court action if no breach of the peace will occur; otherwise, court action will be necessary. If the security agreement so provides, the creditor may require the debtor to assemble the collateral and make it available to the creditor at a reasonably convenient place. Where the collateral is heavy, difficult or expensive to move, or otherwise impractical to move, the creditor may make the collateral "unusable" to the debtor and dispose of it directly from the debtor's possession. Rendering collateral "unusable" does not mean damaging it. Locking the doors to a granary containing grain used as collateral so as to deny access or prevent use by the debtor is a good example. In cases where the lender or seller is unsecured, he can satisfy the debt only from the general credit of the debtor and only after a judgment is rendered in a court of law in favor of the creditor may he proceed to have the debtor's property taken in satisfaction. Since the UCC does not include real property within its provisions, it cannot be used to proceed against a debtor's real property.

North Dakota law provides some additional protection for the debtor beyond the provisions of the UCC. Crop mortgage laws allow a security interest in growing and unharvested crops only to the United States, the state, and any county. It also allows security interests to banking institutions or other agricultural lending agencies or security interests created by contract to secure money advanced or loaned for the purpose of paying government crop insurance premiums or to secure the purchase price or the rental or improvement of the land upon which the crops covered by the contract are to be grown. A section of the crop mortgage law states that a mortgage on crops is not valid as to the crops if the agreement contains any provision claiming a mortgage on any personal property other than the crops. This provision apparently prevents a farmer from tying up all of his personal property, including his crops, in a single agreement. Further, security agreements are subject to the laws governing small loans. These laws control lenders

of money in amounts under $1,000 and generally regulate the interest charges. Another set of laws which prevail over the UCC deal with retail installment sales. These laws generally control the printed forms and agreement and the interest charges in the normal situation of "buying goods on time." Each of these three sets of laws also contains other specific provisions for remedy upon default.

Right to Dispose of the Collateral. Sometimes it may be best to allow the creditor to take the collateral in satisfaction of the debt where the debtor has paid only a small portion of the indebtedness. If the secured party already has possession of the collateral, he must give the debtor, and any other person claiming a security interest in it, written notice of his intention to do so. The creditor may retain the collateral as his own, and the debt is extinguished if no objection is received. This is an inexpensive manner of disposition, and it insures that the debtor will not be liable for any deficiency.

There are, however, two situations in the UCC where the creditor is required to dispose of the collateral and is prevented from accepting it in satisfaction of the debt. The first is when the creditor desires to accept the collateral in satisfaction of the debt. If the debtor or another party holding a security interest in the collateral objects in writing within 21 days, the creditor must then dispose of the collateral in a commercially reasonable manner. The second situation arises when the collateral is consumer goods (a household refrigerator for example); more than 60 percent of the debt has been paid at the time of repossession; and the debtor has not renounced or modified his rights. Here the creditor must dispose of the collateral in a commercially reasonable manner within 90 days after taking possession.

Upon repossession the creditor may sell or lease any or all of the collateral. The proceeds must be used to reduce the amount owed. The debtor must receive the surplus if a disposition of the collateral produces more than what is needed to pay the secured party. Likewise, if the proceeds are not sufficient to pay the amount owed, the debtor is liable for any deficiency.

The collateral may be disposed of through public or private proceedings on any terms, by unit or parcel, and at any time or place, but every aspect of the disposition must be commercially reasonable. The secured party must give reasonable notification of the proceedings to the debtor and to any other person who has a perfected security interest therein, although notification is not required where the collateral is perishable, or threatens to decline in value rapidly. These two exceptions are aimed at avoiding a delay that would reduce the market value of the collateral. A third exception to the notification requirement arises where the collateral is a type customarily sold on a recognized market, such as a stock exchange. The price received through such a sale would ordinarily bring the highest price obtainable. Only the debtor needs to be notified if they are consumer goods.

The secured party may buy the collateral at a public sale if he so desires. He may buy at a private sale only if the collateral is of a type customarily sold in a recognizable market or if it is a type that is the subject of widely distributed price quotations. Such

sales would have little or no prejudice to the debtor since a reasonable price is easily determined, provided, of course, that such a price is actually paid.

The manner of the sale is commercially reasonable if the secured party has: (1) sold in the usual manner in any recognized market; or (2) sold at a price current in such a market at the time of the sale; or (3) otherwise sold in a manner that agreed with the reasonable commercial practices of dealers in the type of property sold.

A court may restrain a secured party's sale if it is about to be accomplished in a manner that is unreasonable or contrary to the UCC or other laws of North Dakota. The secured party is liable to the debtor for any loss suffered if the sale has already been concluded and the manner was unreasonable.

Debtor's Rights. The debtor may redeem the collateral before the secured party has disposed of it or has entered into a contract for its disposition or before the parties have agreed to discharge the obligation. Any other secured party also may redeem in the same manner as a debtor. Redemption is by full payment of the obligation due. The person redeeming also must pay expenses reasonably incurred by the secured party, such as expenses for taking and holding the security. The debtor cannot redeem by paying just the overdue installment where the agreement states that default of one installment causes the entire balance to be due (called an acceleration clause). The debtor is bound by the agreement, and the entire balance must be paid. He can, however, redeem any unsold collateral even if part has already been sold. The right to redemption by the debtor or any other secured party may be waived only by a written agreement after a default has taken place. If this has not been done, the debtor or any other secured party may redeem at any time before the lender disposes of the collateral.

CONCLUSION

This report offers a basic discussion of some aspects of sales and secured transactions under the UCC. One cannot discuss in depth the various provisions of the UCC in this brief report. There are numerous exceptions to the principles as set forth here. You should consult your attorney on any question arising out of a farm business transaction. However, all farmers, as well as other businessmen, should be aware of the UCC's basic provisions and its wide-ranging effect on their affairs.