

# What Arbitrators Need to Know: UCC “Battle of the Forms” and Arbitrability

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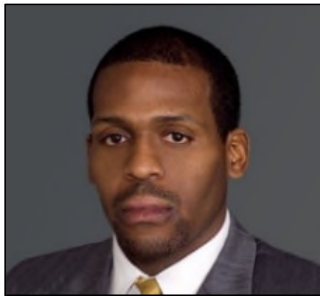


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# Speakers



**Charles E. Harris, II**  
*Partner, Mayer Brown*

- Drafts arbitration agreements and advises on consumer arbitration programs.
- Litigated over a dozen motions to compel arbitration.
- Litigated hotly contested threshold issues of arbitrability.
  - E.g., does a judge or an arbitrator decide if an arbitration agreement permits class arbitration?
- Decided arbitrability as a neutral many times.
  - Rejected the claimant's procedural unconscionability arguments and found that some of the claims in the demand fell within the arbitration agreement and some did not.



**Sarah E. Reynolds**  
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- Drafts and reviews arbitration agreements.
- Represents multinational companies before domestic and international arbitral tribunals, including JAMS, AAA, ICC, ICDR and SIAC.
- Obtains and defends against judicial review of arbitration awards.
- Fellow of the Chartered Institute of Arbitrators.
- Center for Conflict Resolution Trained Mediator.

# Agenda

- Delegation of Arbitrability
- UCC Article 2 Battle of the Forms Provision
- COVID-19-Related Supply Chain Scenario
- Hypotheticals
- Questions and Comments

# Delegation of Questions of Arbitrability to the Arbitrator



- Arbitrability generally raises two questions:
  1. whether there is a valid arbitration agreement, and
  2. whether the particular dispute falls within the scope of that agreement.
- As a general rule, courts, not arbitrators, decide arbitrability.

*Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002).

- The parties may delegate arbitrability to the arbitrator as long as they do so by **clear and unmistakable evidence**.

*First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942-46 (1995); *Rent-A-Center, W., Inc. v. Jackson*, 561 U.S. 63, 69-70 (2010).

# Delegation of Questions of Arbitrability to the Arbitrator (cont.)



## Courts Generally find Clear and Unmistakable Evidence to Delegate in Two Instances:

1. A “delegation clause” confers power to the arbitrator to decide arbitrability.  
**“An arbitrator shall have exclusive authority to resolve any dispute relating to the interpretation, applicability enforceability or formation of this Agreement.”**
2. An arbitration agreement that incorporates the rules of an arbitration body permitting an arbitrator to decide its own jurisdiction (e.g., AAA Commercial Arbitration Rule R-7(a)) constitutes “clear and unmistakable” agreement to arbitrate arbitrability.  
*Allscripts Healthcare, LLC v. Etransmedia Tech., Inc.*, 188 F. Supp. 3d 696, 701 (N.D. Ill. 2016) (collecting cases).
  - Rule R-7(a) empowers an arbitrator to decide gateway arbitrability issues, such as validity and scope of arbitration.
  - “[W]here the parties agree to arbitration pursuant to the rules of the American Arbitration Association (“AAA”), the parties incorporate the AAA’s rules into the arbitration agreement.”  
*Dunston v. R.H. Love Galleries, Inc.*, No. 07 CV 5113, 2008 WL 2339564, at \*2 (N.D. Ill. June 4, 2008) (citing *Commonwealth Edison Co. v. Gulf Oil Corp.*, 541 F.2d 1263, 1272 (7th Cir. 1976)).

# Delegation of Questions of Arbitrability to the Arbitrator (cont.)

## **As a Practical Matter, Questions of Arbitrability will Come Before you in Two Ways:**

1. The plaintiff files a lawsuit, the defendant files a motion to compel, the court rules the arbitration agreement delegates arbitrability to the arbitrator—the plaintiff files a demand in arbitration and asks the arbitrator to rule on whether the dispute is subject to arbitration.
2. A claimant files a demand and the respondent moves to dismiss the arbitration claiming that the subject matter in the demand is not subject to arbitration.



# UCC Article 2 Battle of the Forms Provision

- The UCC was drafted by legal scholars and published in 1952 to harmonize the laws of commercial transactions across states.
- Article 2 of the UCC applies to transactions that are primarily for the sale of goods.
  - If the transaction was primarily for services, then the UCC does not apply even if the sale of goods was part of the transaction.
- Forty-nine (49) states have now adopted Article 2 of the UCC.
  - Some with slight modifications.



## UCC Article 2 Battle of the Forms Provision (cont.)



- “Battle of the Forms” refers to the common situation in which a buyer sends a purchase order for goods that contains its standard terms, and the seller sends an invoice or order confirmation that contains its standard terms; the parties perform without signing a formal agreement.

### Questions that Arise:

1. Is a contract formed when parties exchange forms that contain different terms and the parties don’t sign off on a single document?
  2. If so, what are the terms of that contract?
- The provisions of Section 207 of Article 2 were intended to answer these questions.
  - Most confusing and most often litigated section of the UCC.

Professor Grant Gilmore, a primary drafter of the UCC, called Section 207 “arguably the greatest statutory mess of all time.”



# UCC Article 2 Battle of the Forms Provision (cont.)



## Two Common Law Rules

- Under the common law rule, an acceptance that varied any term of the offer operated as a rejection of the offer, and simultaneously made a counteroffer.
- This common law rule is known as the “mirror image rule,” because the terms of the acceptance had to mirror the terms of the offer to be effective.
- A buyer would by performance constructively accepted the terms of the “counteroffer” despite its differing terms of the supposed acceptance, and be bound by those terms.
- As a result of these rules, the terms of the party who sent the last form, typically the seller, would become the terms of the parties’ contract. This result was known as the “last shot rule.”

# UCC Article 2 Battle of the Forms Provision (cont.)



## Contract Formation

- A contract is formed when the essential business terms (i.e., product, quantity, price, payment, delivery) largely match, **even if** the acceptance includes **different** or **additional** boilerplate terms (e.g., disclaimer of implied warranties, limitations on liability, choice of law, choice of forum, and arbitration agreements).

“A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon.” UCC § 2-207(1).

## What Terms Apply?

- **Different terms.** A majority of jurisdictions follow the “**knockout rule**,” i.e., conflicting terms are knocked out and any remaining gaps are filled by the UCC’s default terms.

*Northrop Corp. v. Litronic Indus.*, 29 F.3d 1173, 1178 (7th Cir. 1994) (describing this approach as “majority rule” and predicting Illinois would adopt “knockout” rule).

# UCC Article 2 Battle of the Forms Provision (cont.)



## What Happens to “Additional Terms”?

- If both parties are not businesses, the additional terms are construed as a counteroffer; in such cases, a contract is usually formed by performance (discussed below).

“[t]he additional terms are to be construed as proposals for addition to the contract.” UCC § 2-207(2).

- **Safe harbor provisions.** For contracts between businesses (called “merchants” in the UCC), the buyer can limit acceptance to the terms of the offer such that additional terms do not become part of the contract by (1) expressly stating in the offer that it limits acceptance to the terms of the offer or (2) notifying the seller within a reasonable time that it objects to the additional terms.

“terms become part of the contract unless ... the offer expressly limits acceptance to the terms of the offer...notification of objection to them has already been given or is given within a reasonable time after notice of them is received.” UCC § 2-207(2)(a), (c).

# UCC Article 2 Battle of the Forms Provision (cont.)



## What Happens to “Additional Terms” (cont.)?

- For contracts between businesses where the buyer has not taken advantage of the safe harbor, any additional term automatically becomes part of the contract unless the term “materially alters” the offer.

UCC § 2-207(2)(b).

- An additional term is a material alteration, which would result in unreasonable surprise or hardship to the non-assenting party.

UCC § 2-207, comment 4 &5.

- Case-by-case analysis of each term, though courts find that some clauses are per se material.
- Materiality requires courts to consider such factors as the value of the transaction, the parties’ relationship, industry custom, the parties’ course of dealing (objective and subjective element).

Nw. 1 Trucking Inc. v. Haro, No. 19-CV-397, 2020 WL 1974379, at \*12 (N.D. Ill. Apr. 24, 2020).

# UCC Article 2 Battle of the Forms Provision (cont.)



## **Seller Can Still Make Counteroffers**

- A seller's response to the offer will be deemed a counteroffer if it states in the invoice or order confirmation that "acceptance is expressly made conditional on assent to the additional or different terms."  
UCC § 2-207(1).
- In that case, no contract is formed via the exchange of forms.
- But courts hold in this situation that performance does not constitute the buyer's acceptance of the seller's counteroffer (i.e., no last shot rule).

## **Contract by Conduct**

- "Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract."  
UCC § 2-207(3).
- The contract "consist of those terms on which the writings of the parties agree"—usually the essential business terms—"together with any supplementary terms incorporated under any other provisions" (i.e., the knockout rule).  
UCC § 2-207(3)..

# UCC Article 2 Battle of the Forms Provision (cont.)



## RECAP

### Is a Contract Formed?

- A contract is formed with a seller's "definite and seasonable expression of acceptance or written confirmation"
- However, a contract is not formed by the exchange of forms if the seller's putative acceptance is "made conditional on assent to the additional or different terms."

### What are the Terms if a Contract is Formed Between Businesses?

- Conflicting (i.e., different) terms are knocked out.
- Additional terms that are immaterial become part of the contract **unless** the buyer expressly limits acceptance to the terms of the offer or objects to the additional terms within a reasonable time.
  - Materiality is often a fact-based analysis; the burden of proving materiality generally falls on the party opposing inclusion.
  - Does the inclusion of the additional term represent undue surprise?

### What are the Terms if the Parties Form a Contract by Performance?

- The agreed-upon business terms become part of the contract together with any gap filler terms under Article 2 of the UCC.

# COVID-19-Related Supply Chain Scenario



**CO. A (DATA CENTER)**



**FRONTLINE WORKERS**



**CO. B (GENERATORS)**



**CO. C (ACOUSTIC CONTAINERS)**

- Company A is a Washington business that operates data centers that house computer systems that provide Internet connections to hospitals and frontline workers.
- Company A emailed a PO from Washington to Company B in Illinois for 100 generators at \$100K to be delivered to Company A's offices in Washington by April 1, 2020.
- Company A's purchase order contains (1) a Washington choice of law provision, (2) does *not* include an arbitration agreement, and (3) does *not* expressly limit acceptance to the PO's terms.
- Company B emails an invoice from Illinois to Company A in Washington agreeing to the quantity, price, and delivery terms in the PO.
- Company B's invoice contains an arbitration clause that delegates to an arbitrator questions as to the validity and scope of the arbitration clause, indicates that the locale of the arbitration is Illinois, and designates the AAA as the administrator. The invoice also includes (1) an Illinois choice of law provision, and (2) does *not* condition acceptance on assent to the additional terms.
- Company A does not object to the additional terms.
- Company A and Company B usually agree to resolve disputes by arbitration when they sign an agreed contract for goods.
- Company C located in India, agreed to provide the acoustic containers that Company B needs to manufacture the generators that Company B agreed to deliver to Company A by April 1, 2020.

# COVID-19-Related Supply Chain Scenario (cont.)



## How Does the Dispute Arise?

- Company C sends Company B a force majeure notice two weeks before Company B is scheduled to deliver the generators to Company A.
- The notice states that, due to the COVID-19 pandemic, Company C will not be able to deliver the acoustic containers on time because India's government has ordered that all factories be closed and issued stay-at-home orders.
- Company B is not able to source the acoustic containers from another vendor so it provides a force majeure notice to Company A indicating that it will not be able to timely deliver the generators as a result of the global crisis.
- Company B covers by buying 100 generators from another company, but each one costs \$75K more.

## Which Party in the Chain Bears the Loss?

- Company B files an arbitration after Company A sends a letter threatening to bring a lawsuit in Washington to recover the amount it paid to cover the goods.
- Company A files a motion to dismiss asking you as the arbitrator to decide whether you have jurisdiction to hear the dispute in accordance with the applicable arbitration rules.



# COVID-19-Related Supply Chain Scenario (cont.)



## 1. Determine what State's Law Governs the Dispute - Why?

There may be variances in the UCC terms adopted by two states (not often), and some states have found that arbitration agreements are per se material (overwhelming minority view).

*Allied-Bruce Terminix Co. v. Dobson*, 513 U.S. 265, 275 (1995) (the FAA basic purpose is to “put arbitration provision on ‘the same footing’ as a contract’s other terms.”).

### Here:

- There is no conflict between Illinois and Washington law so no need for conflict analysis (but assume there is a conflict for this analysis).
- Company A chose Washington law in its PO and Company B chose Illinois law—knockout rule applies.
- Would look to Illinois’ choice of law principles to determine what state’s law applies (in practice, arbitrators usually apply the choice-of-law rules of the seat of arbitration).
- In this case, Illinois has adopted the ‘most significant contacts’ test in deciding choice-of-law disputes with respect to contractual issues (relevant factors include the place of contracting, negotiation, performance, location of the subject matter of the contract, and the domicile, residence, place of incorporation, and business of the parties).

## 2. Determine Whether Article 2 of the Applicable State's UCC Applies.

- The transaction is primarily for the sale of goods (i.e., generators).

# COVID-19-Related Supply Chain Scenario (cont.)



## 3. Was a Contract Formed?

There was a definite and seasonable acceptance by Company B (i.e., the invoice)—Company B didn't make acceptance conditional on assent to the additional or different terms.

## 4. Is the Contract Between Businesses?

Yes.

## 5. Were there Conflicting Terms Relevant to the Arbitration Agreement?

We already identified that the choice of law provisions in the forms were knocked out.

## 6. Did the Buyer Limit Acceptance to the Terms of the Offer?

No.



## COVID-19-Related Supply Chain Scenario (cont.)



### **7. Did the Buyer Object to the Addition of the Arbitration Agreement (within a Reasonable Time)?**

No.

### **8. Does the Inclusion of the Arbitration Agreement Result in an Unreasonable Surprise?**

Probably not a surprise here given the parties' course of dealing—many courts find that course of dealing is the most important consideration when looking at materiality.

Also remember that the FAA reflects a strong public policy in favor of enforcing arbitration agreements.

*Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (The FAA "is a congressional declaration of a liberal federal policy favoring arbitration agreements").

# UCC Section 2-207 Flowchart



# Hypothetical #1

- Buyer company called Seller company to place an order for 40,000 lbs. of apple powder.
- Buyer told Seller the purchase was subject to PO and gave Seller the PO number, but never sent the PO to Seller.
- The PO included printed provisions that contained the following text:

“Additional or substitute terms will not become part of this contract unless expressly accepted by Buyer; Seller's acceptance is limited to the terms of this order, and no contract will be formed except on these terms.”
- Seller sent Buyer a “Confirmation” shortly after the telephone call that listed the quantity, price, shipping arrangements, and payment terms.
- The Confirmation included printed provisions that contained the following text:

“ALL DISPUTES UNDER THIS TRANSACTION SHALL BE ARBITRATED IN THE USUAL MANNER.”
- Seller had sent a similar confirmation to Buyer in nine prior transactions and Buyer never objected.
- Buyer had sent the PO in at least two of those nine transactions.

**Is Buyer’s breach of contract action arbitrable? Assume there are no choice of law issues.**

## Hypothetical #1 (cont.)



*Schulze & Burch Biscuit Co. v. Tree Top, Inc.*, 831 F.2d 709 (7th Cir. 1987)

- **Held**, “the addition of the arbitration clause was not a material addition to the contract.”

“In this case, neither Brady nor Tree Top [Seller] could have seen the purchasing offer with the limiting language. Although Schulze [Buyer] had sent a purchase order in two of the previous nine transactions, that is **insufficient to give notice that mere reference to the number of a purchase order is intended ‘expressly’ to make the order acceptable only on the terms in a purchase order that remains unseen.**”

“In the present case, **Tree Top's agent Brady had sent a confirmation form containing the same arbitration provision to Schulze in each of the previous nine transactions he brokered** between the two parties. Schulze had ample notice that the tenth confirmation would be likely to include an arbitration clause. To prevent the clause from becoming part of the contract, Schulze needed only to give notice of objection within a reasonable time. ”

## Hypothetical #2



- Buyer, a Korean company, called the Seller in California from Korea to provide details of an order for walnuts.
- Seller sent an email that attached a pro forma invoice; that invoice did not include any contract terms for the order.
- Buyer paid for the order by wire transfer.
- Buyer emailed Seller providing the details for a second order of walnuts and asked the Seller to send a pro forma invoice for the order.
- This time, the Seller sent Buyer a "Standard Confirmation" that included the terms of the purchase.
- Below the signature lines are the words, the confirmation stated:

"All disputes arising out of or in connection with the Contract shall be finally settled in Los Molinos California under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules" and "shall be governed by the laws of the State of California including the Uniform Commercial Code as enacted in California."

**Is Seller's breach of contract action arbitrable?**

## Hypothetical #2 (cont.)



*Shany Co. v. Crain Walnut Shelling, Inc.*, No. CIV. S-11-1112 KJM, 2012 WL 1979244 (E.D. Cal. June 1, 2012).

- **Held**, the arbitration provision was not a material alteration to the contract.

“Shany [Buyer] suggests it was surprised by the arbitration term because there was no prior course of dealings that put it on notice of the arbitration provision of Crain's [Sellers'] contract and because there was no mention of it during the parties' negotiations....Shany has cited nothing holding that a prior course of dealings is indispensable to rebutting a claim of surprise....In addition, **Crain has presented information, albeit in the form of journal articles, suggesting that arbitration provisions are standard in international contracts** and so Shany should not have been surprised by the inclusion of such a provision.”

- The court applied California substantive law without doing an analysis.



## Hypothetical #3



- Buyer initiated purchases of nylon from Seller by sending its standard PO forms.
- The PO stated:

“Any controversy arising out of or relating to this contract shall be settled by arbitration in the City of New York or Boston as [Buyer] shall determine in accordance with the Rules then obtaining of the American Arbitration Association or the General Arbitration Council of the Textile Industry, as [Buyer] shall determine.”
- Seller sent Buyer invoices containing the following language:

“This document is not an Expression of Acceptance or a Confirmation document as contemplated in Section 2–207 of the Uniform Commercial Code. The acceptance of any order entered by [Buyer] is expressly conditioned on [Seller's] assent to any additional or conflicting terms contained herein.”
- Buyer usually paid Seller within 30 days after receiving the invoice.

**Is Buyer’s breach of contract action arbitrable? Assume there are no choice of law issues.**

## Hypothetical #3 (cont.)

*Commerce & Indus. Ins. Co. v. Bayer Corp.*, 742 N.E.2d 567 (Mass. 2001).

- **Held**, the parties formed a contract by conduct, not in the writings of the parties, that does not comprise the arbitration agreement.

“Bayer [Seller] correctly concedes that its contract with Malden Mills [Buyer] resulted from the parties' conduct, and, thus, was formed pursuant to subsection (3) of § 2–207. A contract never came into being under subsection (1) of § 2–207 because ... paragraph fourteen on the reverse side of Bayer's invoices expressly conditioned acceptance on Malden Mills's assent to 'additional or different' terms.”





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