THE BUYER AND THE LAW

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CPM

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This book is dedicated to my wife, Ruth, who endured my writing pains and frustrations with great patience and who constantly offered encouragement and often insightful counsel.

Preface

It is most important that the reader grasp the concept and thrust of this book. *The intent is not to turn each buyer into a lawyer. The intent is to alert the buyer to potential pitfalls in the business of buying that might be a source of trouble. The Buyer and the Law* is not a detailed analysis of the law as it pertains to the relationships between buyer and seller. It is an overview of the possible legal ramifications of situations buyers will encounter in the daily performance of their jobs. The author urges buyers to seek legal counsel if they have any doubts about their position at any time. The book is intended to be a desktop working tool, providing buyers with an easy means of checking the potential for trouble in a given situation.

As business becomes more complicated, attempts by sellers to limit their liability under a contract become more sophisticated, and the need for overseas procurement increases, buyers will face more potentially troublesome situations than they have in the past. Therefore, buyers must understand their rights and obligations under the law, be able to assess dangerous situations quickly, and have the ability to recognize when it is time to seek legal counsel. *Smart buyers rarely end up in court.* Be smart—get legal counsel early.

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Contents

1 . . . The Agency Relationship

The buyer operates under two legal concepts: the law of agency and the law of contract. Transactions for the sale of goods in the United States are governed by the Uniform Commercial Code. (Litigation in Louisiana is subject to state statutes and the concepts of the common law formerly used in every state.) The Uniform Commercial Code (UCC) is the most complete compilation of commercial law ever attempted in the history of the Anglo-American legal system. It relates to and covers all phases of commercial law including negotiable instruments, bank deposits, collections, secured transactions, sale of goods, and many other facets not pertinent to the needs of the buyer, or purchasing employee.

The UCC was written after many years of research and consultation by the American Law Institute and the Conference of Commissioners on Uniform State Laws. It was finalized and promulgated in 1950, and the first state to accept it was Pennsylvania in 1954. It has since been adopted by every state except Louisiana. The objective of the UCC was to formalize and stabilize the various state laws and court decisions to relieve the disparity among states' laws. It supersedes contrary court decisions and previous statutes.

What Is an Agent?

Buyers operate basically under the law of agency in terms of their relationship with their employers. Normally, not too many problems arise regarding this relationship. However, the

relationship should be understood, because there are some potential hazards to the buyer if it is breached.

An *agent* is a person, or party, authorized to act under the control of and for the benefit of a second party, who is generally referred to as the principal. Any acts of the agent will obligate the principal to a third party. Along with the obligation status, the principal also has rights against that third party.

Purchasing employees are true agents in that their actions are taken in behalf of a principal. The term agent is often misused, especially where there is reference to agencies such as a real estate agent, an automobile agency, and so forth. These generally are not true agencies, but usually represent situations in which an individual or company has secured the right to sell a product in a given area. In fact, these are really franchise arrangements. The purchasing employee is a true agent because the transactions that are consummated do bind the principal with third parties. (It should be noted here that there are some situations in the real estate business where the real estate agent has the authority to bind the principal in deals with a third party.)

TYPES OF AGENTS

There are two basic types of agents: the general agent and the special agent. The general agent is one who is employed by a principal on a continuing basis at a given place of employment, and who is empowered to transact a particular type of business or trade. The purchasing employee is a typical example of a general agent. The special agent is a slightly different breed. The primary difference is that the special agent has limited powers to act for the principal. The limitation is generally a restriction stating that the agency is for only one transaction. In one possible expansion of the special agency, the restriction can pertain to a series of transactions that are related, but are still basically a one-time deal.

The difference between these two is important for the buyer to understand. The general agent acts for the principal on a continuous basis. As a result, if the agent does engage in

unauthorized acts, the principal will still be bound by the agent's actions. The key is the fact that the agent has acted for the principal on a continuous basis. However, in the case of the special agent, the principal will *not* normally be responsible or liable for the unauthorized acts of the agent.

How Is Agency Authority Formed?

An express authorization by a principal that a given person is authorized to act in behalf of the principal is effective in creating an agency. This relationship may be created by an oral declaration or a written document. Depending on where the agency is being created (i.e., in what state), the statutes may require the agency to be formalized by a written statement. Also, the purpose of the agency may affect whether or not the principal must appoint the agent in writing. Normally, a buyer does not have a written statement indicating the existence of an agency relationship. However, if a principal treats a person as an agent and acts in such a way as to lead others to believe that the person is performing as an agent, such conduct of the principal works in the same way as an oral or written expression of an agency relationship. An agency relationship may be confirmed by the principal by means of ratification of an action taken. In this case the person is not authorized to act as an agent, but does so act. If the principal, on learning of the action, agrees with the action and completes the performance according to the arrangement, then, in effect, the principal ratifies the person as an agent.

APPARENT AUTHORITY

In purchasing, it is fairly common for a seller to rely on a buyer's authority as a result of the fact that the buyer occupies the position. If the principal has not given express authority but permits the purchasing employee to act as if the authority has been granted, and if the third parties with whom the dealings are being carried on believe that the employee has the

authority to act, an agency exists. This is referred to as *apparent authority.*

CUSTOMARY AND INCIDENTAL AUTHORITY

An agent may have *customary authority,* which means the authority to do the things that are necessary, normal, and customary for the business involved. An agent may also have *incidental authority,* which allows the agent to perform duties beyond the scope of the agency, if such incidentals are pertinent to completion of the delegated duties.

When the agent has the proper authority, regardless of its kind, and makes a contract with a third party, and when such contract binds the agent's company, then there is a binding arrangement between the principal (i.e., the company) and the third party to the contract. Technically, the agent is not a party to the contract. The contract exists between the principal and the third party.

What Are the Responsibilities of the Parties?

DUTIES OF THE THIRD PARTY

Third parties have some duties relevant to the agent's authority. In actual practice, the third party may not rely on the statements of the agent regarding the limits of the agent's authority. If the seller, who is the usual third party in sales transactions, has any reason to believe that the agent is exceeding his or her authority or does not have authority in a given area or authority to make a particular deal, then the seller is operating at his or her own risk. However, if the seller is not aware of any limitations on the authority of the agent and if the agent has made no statements regarding such limitations, then the seller is on relatively safe ground in proceeding. The best rule for a seller to follow, if there is any doubt as to the

authority of the agent, is to check it out before going any further. A seller, relying on the apparent authority of the agent, tends to operate normally in completing a transaction. Limitations imposed on buyers that are not communicated to sellers, or third parties, do not bind those parties.

RESPONSIBILITIES OF THE PRINCIPAL

RESTRICTIONS ON BUYERS' AUTHORITY. It is the responsibility of a purchasing department to organize itself so as to place whatever limitations necessary on its buyers. These restrictions on the buyers' power, or authority to commit, must be communicated to all third parties to avoid conflicts. The usual way to accomplish such limitation is by setting a dollar amount constituting the upper commitment limit of the buyer. Anything purchased over the limit requires the additional signature of the next higher official in the department. If there is a commitment made by a buyer over the limit, the company should, as a measure of protection, immediately advise the seller that the individual exceeded the limitation.

CURTAILMENT OF "BACK DOOR BUYING." A type of purchasing situation known as "back door buying" is very common, generally arising in plants where the supervisors or the maintenance people get into the habit of placing orders without the sanction of the purchasing department. If not curtailed, this can become quite a worrisome problem, as well as an uncontrolled expense. The solution is to advise all sellers that *no one* except authorized purchasing employees can commit the company and that no invoices will be paid unless accompanied by a signed purchase order from the purchasing department. By sending notice to the sellers, the company has shifted the burden of compliance to their backs. All future back door sales will then be done at the seller's risk. This approach, although probably infuriating to all of the amateur buyers rampant in a company, puts the responsibility for buying where it belongs—in purchasing. By disclosing the limitations on the authority of its buyers, a company protects itself against all third parties.

OBLIGATIONS OF AGENTS TO THEIR PRINCIPALS

Agents have a wide range of obligations to their principals. The purchasing agent's position is a typical example of an agency relationship, and it results in the agent having certain obligations to the principal.

LOYALTY. The purchasing agent must be loyal to the principal. This precludes the agent from taking advantage of the principal in any way. There must be no secret dealings, no skimming of monies, no secret profits, and no private deals where the agent will profit without the knowledge of the principal. The agent must not accept any form of gift, payback, kickback, or commission from sellers. Although this seems fairly obvious on the surface, abuses of the agency relationship are, unfortunately, more common than the profession likes to admit.

The question of loyalty is really a matter of buyers' having their ethics in order. Guidelines for ethics in the purchasing profession have always been a subject for discussion. The resolution of this issue is relatively simple. First, buyers' pay scales should be competitive with industry standards. Second, the opening part of a company's purchasing manual should be a set of rules on what is acceptable ethical conduct for a purchasing person in that company. Finally, the senior management of the purchasing department must set a good example of correct professional conduct.

The matter of loyalty to one's principal is a very serious concern. The agent must make sure that the principal is advised of all actions taken. The withholding of information, slanting of information, or even selecting of information by the agent is disloyal. The principal is entitled to full disclosure, and anything less is not sufficient.

PROPER PERFORMANCE. Agents are bound to carry out the orders and instructions of their principals to the letter. Agents may not exceed instructions or go beyond the limitations set by their principals. In so doing an agent may well bind the

company with a third party, usually a seller who is dealing with the purchasing agent in good faith, relying on apparent authority, and believing that the agent is operating within the set limitations. A buyer who exceeds his or her authority may be *personally liable.* If a purchasing agent makes a purchase over the authorized limit, even if it is performed in good faith, with the belief that the action will be to the benefit of the company, there is still a problem. If, on such a transaction, the company suffers a loss, the purchasing agent is personally liable for the amount, should the company choose to pursue the matter.

The determining factor in these kinds of situations usually boils down to the concept of the "reasonable man." This theory revolves around the idea of what is reasonable activity in the particular circumstances. The situation, the buyer's level of experience, the market circumstances, possible pressures on the buyer resulting from the company's financial status, and the limits of authority are all considered when the courts are trying to decide if a buyer performed reasonably. It is not difficult to envision any number of situations in which a buyer might take extra risks or possibly exceed the stated authority in order to protect the company in the current state of the marketplace. The "reasonable man" approach is a good one because it allows for the evaluation of conditions and circumstances that may have affected a buyer's decisions.

STANDARDS FOR AN AGENT'S PERFORMANCE. In determining how well an agent should perform, the courts apply the *reasonable care,* or *reasonable performance, guideline.* The reasonable care concept takes into consideration the market circumstances and the general ability, skill level, and professional experience of the buyer. The buyer must do the job with reasonable ability. Buyers must ferret out the necessary information, stay abreast of new developments in the industry, plan properly when negotiations are involved, do the necessary analysis of the industry, and gather the data needed to run a smoothly functioning purchasing operation. A buyer is not expected to know everything that is new in the given industry at any given moment but is expected to be reasonably aware of new

developments, processes, products, and so on. Failure to stay abreast of improvements in the industry could, under certain circumstances, put a buyer in a position of personal liability. An example of such a circumstance is a buyer's causing a loss to the company as a result of an obvious failure to know about a better way to do something or a new product that might have saved the company substantial amounts of money.

If a buyer is just plain sloppy or negligent on the job, there are probable grounds for personal liability. However, if a buyer uses due care, consistent with his or her experience, and the deal goes sour, the buyer is in no jeopardy. The determination of reasonable performance then becomes a question of fact relating to the status of the buyer.

OBLIGATIONS OF THE PRINCIPAL TO THE AGENT

Until this point, the emphasis has been on the duties and obligations of the agent to the principal. However, definite obligations of the principal to the agent do exist. The purchasing agent, who normally operates as a salaried employee of the principal, is entitled to be paid for any expenses incurred while in the process of handling the job for the principal.

The principal must indemnify the buyer against any personal liability to a third party. This type of liability usually comes about as the result of a mistake by the buyer. A mistake does not necessarily imply lack of reasonable care. If the buyer operated with diligence and normal care, and a mistake still occurred that caused a loss to a third party, the principal is obligated to support and protect the buyer from loss.

When Is the Agent Liable to a Third Party?

A buyer becomes liable to a third party when the buyer definitely exceeds his or her authority and, in so doing, causes a loss to a third party. If a buyer represents himself or herself to

a third party as having the authority to represent a principal, and the third party relies on that representation, acts accordingly, and is injured (i.e., suffers a loss), the buyer can be held personally liable for reimbursement of the loss. An unusual situation is the case where the principal is either completely undisclosed or partially undisclosed. In this case the third party is usually unaware that the dealing is with an agent and thus believes that the agent is actually the principal. In this circumstance, the agent may be liable to the third party. If the third party is informed that the agent is acting for a principal but there is no disclosure of the name of the principal, in the event of controversy the agent could be liable to the third party.

Some interesting developments in these situations concern the rights of action of the parties. The third party *may* sue the undisclosed principal once the principal has been identified, even though the third party thought all along that the agent was the principal. The kicker is that, after the principal has been disclosed, if the third party chooses to hold the agent liable, then the third party is barred from suing the principal. The undisclosed principal may sue the third party, even though at the time the agreement was made by the agent and the third party, the principal was undisclosed. The agent may also sue the third party, but this ability to sue is secondary to the right of action of the principal. (Fortunately, this type of situation does not occur often; however, it is wise to be aware of the possibility of this potential problem in private dealings.) There is also the possibility that a buyer might deliberately assume liability on a given deal. It is hard to imagine someone with an intellectual level that low continuing to be employed as a buyer. However, there have been cases where this has happened.

DETRIMENTAL RELIANCE

A rather undeveloped area of law just becoming more active, to which the buyer should be alerted for the future, involves the case in which a third party, usually a seller, acts upon information given by a buyer, and then the promises of the

buyer are not fulfilled. This situation can sometimes develop without the buyer having realized what is happening at the seller's company. It is conceivable that a buyer will tell a seller that an order will be coming through and that the seller is to take the necessary steps to meet the delivery date. This might require the seller to expend funds for equipment, raw materials, or extra labor. When the deal falls through, the seller is definitely injured and has recourse against the buyer's company even though there was not a legal contract between the two. This *detrimental reliance* is a part of contract law that often overlaps with the law of agency.

VIOLATION OF THE LAW

If a buyer fails to comply with any laws, it is possible to incur personal liability for actions or, in some cases, for failure to act. Suppose, for example, that there is a broken plate-glass window on the buyer's building, and the buyer is charged with the responsibility of getting it fixed. Reasonable care indicates that the buyer should take all necessary precautions to protect any member of the public from injury. If the buyer fails to take such care and someone is injured, the buyer (or agent) is liable along with the principal. A buyer must also take care not to violate laws just to relieve any pressure that has been placed on him or her. For example, if there is pressure to reduce costs to the lowest possible point, and a buyer, with a desire to please management, extracts a discriminatory price from a seller, the buyer has broken the law. The key is that the buyer knew the price to be discriminatory and proceeded regardless. In these circumstances the buyer and the company are liable for violations of the Robinson-Patman Act. (See Chapter 7.)

In the rare case where an agent engages in outright fraud or deliberate misrepresentation while functioning within his or her authority, and someone is damaged or injured, the principal is liable. However, the principal then has recourse against the agent. In some states the courts have ruled that the principal is not liable if the principal was unaware of the situation and did not authorize the action.