

1991

## An Appraisal of the March 1, 1990, Preliminary Report of the Uniform Commercial Code Article 2 Study Group

John D Wladis

Task Force of the ABA Subcommittee on General Provisions, Sales, Bulk Transfers, and Documents of Title, Committee on the Uniform Commercial Code, *Task Force of the ABA Subcommittee on General Provisions, Sales, Bulk Transfers, and Documents of Title, Committee on the Uniform Commercial Code*

# Delaware Journal of Corporate Law

---

VOLUME 16

1991

NUMBER 3

---

## AN APPRAISAL OF THE MARCH 1, 1990, PRELIMINARY REPORT OF THE UNIFORM COMMERCIAL CODE ARTICLE 2 STUDY GROUP

PREPARED BY A TASK FORCE OF THE A.B.A.  
SUBCOMMITTEE ON GENERAL PROVISIONS, SALES,  
BULK TRANSFERS, AND DOCUMENTS OF TITLE,  
COMMITTEE ON THE UNIFORM COMMERCIAL CODE\*

### TABLE OF CONTENTS\*\*

	<i>Page</i>
Preface.....	984
Revision or Clarification Through the Use of Code Comments ...	996

---

\* The members of the Task Force who participated in the preparation of this Appraisal were Roy Ryden Anderson, Roger D. Billings, Jr., Donald F. Clifford, Jr., David Frisch, Henry Gabriel, Gregory Gelfand, Mark E. Roszkowski, Peter Winship, and John Wladis. As a member of the Task Force, Professor Winship prepared a memorandum on the relevance of the U.N. Convention on Contracts for the International Sale of Goods, for the revision of Article 2. This memorandum is not reproduced here.

This article represents a consolidation of the Article 2 Study Group's Preliminary Report and the A.B.A. Task Force's Appraisal of the Study Group's Preliminary Report.

The Study Group's Preliminary Report and the appendices to the Task Force's Appraisal are unedited and reprinted in full. The Study Group's Preliminary Report is presented in italics, and bold typeface is used to emphasize the Study Group's recommendations.

The Study Group's remarks concerning each U.C.C. section are followed by the corresponding remarks from the Task Force's Appraisal. Each part of the Study Group's Preliminary Report contains an independent series of footnotes commencing with the number "1." The Task Force's Appraisal contains one continuous series of footnotes.

Please note that the Study Group is occasionally referred to as the "Study Committee" in the Study Group's Preliminary Report.

\*\* Table of Contents references are to the A.B.A. Task Force's Appraisal. U.C.C. sections italicized in the Table of Contents are exclusively discussed in the Study Group's Preliminary Report, and the corresponding page numbers refer to the Preliminary Report.

The Substantive Coverage of Article 2 .....	997
Consumer Considerations .....	1000
Article 1—Part 1 .....	1010
1-103 .....	1010
1-105 .....	1013
1-106 .....	1014
1-201(9) .....	1015
1-203 .....	1016
1-205 .....	1019
1-206 - 1-207 .....	1019-1020
Article 2—Part 1 .....	1021
2-101 .....	1021
2-102 .....	1025
2-103 .....	1029
2-104 .....	1030
2-105 .....	1031
2-106 .....	1031
2-107 .....	1032
Article 2—Part 2 .....	1038
2-201 .....	1038
2-202 .....	1045
2-203 .....	1050
2-204 .....	1050
2-205 .....	1051
2-206 .....	1053
2-207 .....	1057
2-208 .....	1067
2-209 .....	1070
2-210 .....	1073
Article 2—Part 3 .....	1084
2-301 - 2-312 .....	1073-1081
Warranties - General .....	1084
2-313 .....	1089
2-314 - 2-315 .....	1105-1106
2-316 .....	1108
2-317 - 2-328 .....	1112-1121
Article 2—Part 4 .....	1121
2-401 - 2-402 .....	1121-1122
2-403 .....	1125
Article 2—Part 5 .....	1128
2-501 .....	1128
2-502 .....	1129

2-503 .....	1131
2-504 - 2-506 .....	1132-1133
2-507 .....	1135
2-508 .....	1138
2-509 .....	1152
2-510 .....	1154
2-511 - 2-515 .....	1155-1157
Article 2—Part 6 .....	1159
2-601 .....	1159
2-602 - 2-606 .....	1160-1163
2-607 .....	1165
2-608 .....	1168
2-609 .....	1170
2-610 - 2-611 .....	1171-1173
2-612 .....	1175
2-613 .....	1192
2-614 .....	1194
2-615 .....	1198
2-616 .....	1203
Article 2—Part 7 .....	1205
2-701 .....	1205
2-702 .....	1210
2-703 .....	1211
2-704 .....	1212
2-705 .....	1213
2-706 .....	1215
2-707 .....	1216
2-708 .....	1222
2-709 .....	1226
2-710 .....	1227
2-711 .....	1228
2-712 .....	1228
2-713 .....	1231
2-714 .....	1233
2-715 .....	1234
2-716 .....	1236
2-717 .....	1237
2-718 .....	1239
2-719 .....	1243
2-720 .....	1244
2-721 .....	1244
2-722 .....	1245



2-723 .....	1246
2-724 .....	1246
2-725 .....	1248
Appendices to Task Force Report.....	1251
Appendix A: General Comment on Parts II and IV: Formation and Construction .....	1251
Appendix B: Draft for a "Uniform Sales Act, 1940" § 69.....	1281
Appendix C: Revised Uniform Sales Act, Second Draft (Dec. 1941) §§ 59-59D.....	1284
Appendix D: Transcript, N.C.C.U.S.L. Fifty-Second Annual Conference, Aug. 18-22, 1942, Discussion of Revised Uniform Sales Act, Proposed Sections on Merchant Juries .....	1292
Appendix E: Comment on Section 5-8 (S77) Cure of Improper Tender or Delivery; Replacement.....	1313
Appendix F: Comment on Section 7-9 (S101) Breach in Installment Contracts .....	1317

## PREFACE

In the spring of 1988, the Permanent Editorial Board for the Uniform Commercial Code, with the approval of the National Conference of Commissioners on Uniform State Laws and the American Law Institute, began a formal study of Article 2 with the goal of reaching a decision as to whether the text should be revised. To this end, a Study Group was appointed, and Professor Richard E. Speidel of Northwestern University was selected to serve as Project Director.<sup>1</sup> On March 1, 1990, after two years of study, the Study Group issued a 245-page preliminary report for general public discussion and consideration.<sup>2</sup>

The Business Law Section of the American Bar Association has long played an important role in the evolutionary development of the Uniform Commercial Code. Since 1947 it has, through its divisions and committees, carefully studied each draft as it was produced, ex-

---

<sup>1</sup> See Speidel, *Committee Studies Revising U.C.C. Article 2*, 8 Bus. Law. Update 3 (1988) (No. 6) (discussing the Article 2 Study).

<sup>2</sup> An Executive Summary was issued by the Study Group on March 1, 1991. On August 6, 1991, the National Conference of Commissioners on Uniform State Laws authorized the creation of an Article 2 Drafting Committee and the appointment of a Reporter.

pressed opinions on policy matters, and made suggestions for improvements. Continuing this tradition of participation, the Subcommittee on General Provisions, Sales, Bulk Transfers, and Documents of Title of the Committee on the Uniform Commercial Code undertook the task of formulating conclusions with respect to the Preliminary Report. The work of the Subcommittee began in May 1990 with the assemblage of a ten-member Task Force. What follows is the report of that task force.

In the preparation of its report, the Task Force sought to consider not only the substantive content of the Study Group's section-by-section recommendations, but also more pervasive matters such as the scope and approach of the Preliminary Report. Although not all members of the Task Force share the Study Group's implicit viewpoint that revision is due for Article 2, the prevalent opinion is that the bulk of the Study Group's recommendations are sound and that revision is desirable. Other subcommittees of the Uniform Commercial Code Committee of the American Bar Association have also conducted studies of the Preliminary Report, and their reports should be looked to for more particularized views of the Preliminary Report.

David Frisch, Chair  
Subcommittee on General Pro-  
visions, Sales, Bulk Transfers,  
and Documents of Title

NOTE: The opinions and conclusions expressed in the Task Force Report were not submitted to any body for approval. The Report does not necessarily reflect the opinion of the full Subcommittee on General Provisions, Sales, Bulk Transfers, and Documents of Title, the Uniform Commercial Code Committee, the Business Law Section, or the American Bar Association.

*[PRELIMINARY REPORT - INTRODUCTION]*

**ARTICLE 2, SALES:  
HISTORY, DRAFTING AND BASIC POLICIES**

**A. A BRIEF LEGISLATIVE HISTORY OF ARTICLE 2.**

*The British Sale of Goods Act, enacted by Parliament in 1893,<sup>1</sup> was used by Professor Samuel Williston as a model for the Uniform Sales Act (USA), which was promulgated in 1906. The USA was ultimately enacted in 34 states, the last enactment occurring in 1941.<sup>2</sup> Grant Gilmore, writing in 1948, described the USA as a "scholarly reconstruction of 19th Century law" which, in 1906, "failed to move the law much closer to us than 1850."<sup>3</sup> It was, in short, a prime example of what he and others have called "classical" contract law.*

*In 1937, the Federal Sales Bill (The Chandler Bill), which was sponsored by the New York City Merchant's Association and other commercial groups, was drafted.<sup>4</sup> The Bill, which was based on the USA, was introduced in Congress in 1937 but never enacted.*

*The first drafts of a revised Uniform Sales Act were completed in 1940.<sup>5</sup> These early efforts culminated in 1944 with a proposed Uniform Revised Sales Act.<sup>6</sup> The 1944 Draft was a joint project of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute. Karl N. Llewellyn was the Reporter and Soia Mentschikoff*

---

1. Discussions of English sales law prior to 1893 are found in Llewellyn, *Across Sales on Horseback*, 52 Harv. L. Rev. 725 (1939); Stone, *The Origins of the Law of Sales*, 29 L.Q. Rev. 442 (1913).

2. See Braucher, *The Legislative History of the Uniform Commercial Code*, 58 Colum. L. Rev. 798, 799 (1958) (hereinafter Braucher, *Legislative History*).

3. Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 Yale L. J. 1341, 1341-42 (1948). According to Gilmore, the USA failed because it neglected to "clarify the law about business transactions" that in fact occurred. *Id.* According to Karl N. Llewellyn, the USA was "obscure," "uncertain," "misleading," too "technical" and contained numerous "traps" for the ordinary businessman acting in good faith. See Llewellyn, *Article 2, A Brief Opening Statement in Favor of the Article*, N.Y. Law Rev. Commission, *Study of the Uniform Commercial Code* 5 (1954).

4. The Bill is reprinted as H.R. 8176 (1940), in I Kelly, *Uniform Commercial Code Drafts* 113-69 (1984) (hereinafter Kelly). The Kelly volumes include drafts of the UCC issued by the American Law Institute and the National Conference of Commissioners on Uniform State Laws from 1940-62. See also Symposium, *The Proposed Federal Sales Act*, 26 Va. L. Rev. 537 (1940).

5. See I Kelly at 174-260.

6. The 1944 Draft with extensive commentary is reprinted in II Kelly 1-79, 80-278.

was the Associate Reporter for the 1944 draft and for much of the work that followed.

By 1949, there was a first draft of a proposed Uniform Commercial Code with comments. In the 1949 Draft, Article 2, Sales, was a further revision of the Uniform Revised Sales Act.<sup>7</sup> In May, 1950, a "Final Draft" of the UCC, with Text and Comments, was proposed.<sup>8</sup> But in September, 1950, further revisions in Article 2 were recommended and the work continued. A Proposed "text only" Final Draft #2 was then issued in the Spring of 1951<sup>9</sup> and an Official Draft with Comments was issued later that year.<sup>10</sup> Text changes in this draft were proposed by the recently created Editorial Board for the UCC (EB), and the 1952 Official Draft, with changes, was finally promulgated as the 1953 Official Text.<sup>11</sup> The 1953 Official Text of the UCC was enacted by Pennsylvania in April 1953, effective on July 1, 1954.<sup>12</sup> In response to a recommendation by the Association of the Bar of the City of New York,<sup>13</sup> the New York Law Revision Commission held extensive hearings on the UCC in 1954. A detailed report of their analysis and conclusions was issued in 1955,<sup>14</sup> and a condensed report and recommendation was submitted to the New York General Assembly in 1956. The conclusions were critical of the 1953 Official Draft of the UCC,<sup>15</sup> including Article 2.<sup>16</sup> The New York Report prompted the EB to review earlier

---

7. See VI Kelly 47-263.

8. Article 2 of that Draft is reprinted in X Kelly 351-56. The proposed drafts of Article 2 in 1949 and 1950 were the subject of Professor Williston's famous attack, Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 Harv. L. Rev. 561 (1950), and Professor Corbin's spirited defense, Corbin, *The Uniform Commercial Code-Sales: Should it be Enacted?*, 59 Yale L.J. 821 (1950).

9. See XII Kelly 416-83.

10. XIV Kelly 43-174.

11. XVI Kelly 55-264.

12. Pa. Stat. Ann. tit. 12A (1954).

13. XV Kelly 307-42.

14. See New York Law Revision Commission Report for 1955, *Study of the Uniform Commercial Code* (1955)(hereinafter Report)

15. Two conclusions of the Report were that the UCC was "not satisfactory in its present form" and that it "cannot be made satisfactory without comprehensive re-examination and revision in the light of all critical comment obtainable." Report of the Law Revision Commission to the Legislature Relating to the Uniform Commercial Code, Leg. Doc. 65A, 57-8 (1956). See also, Braucher, *Legislative History* at 803-04.

16. See Report of the Law Revision Commission to the Legislature at 40-46. According to William Schnader, the Commission discussed 40 of Article 2's 102 sections. Of these 22 were approved, 13 were criticized but none was disapproved. More importantly, the Commission approved the five main features of Article 2, namely: (1) Abandonment of title as a test for determining legal obligations; (2) The distinction between merchant and non-merchant sellers and buyers; (3) Relaxation of the statute of frauds; (4) New provisions dealing with rules of construction or the implication of particular terms; and (5) Significant

recommendations for change in the 1953 Text of Article 2<sup>17</sup> and to recommend further revisions in 1956.<sup>18</sup> These second thoughts lead to the promulgation of the 1958 Official Text with Comments<sup>19</sup> and the ultimate enactment of the complete UCC by every state except Louisiana.<sup>20</sup>

Although other Articles of the UCC have been revised since 1958<sup>21</sup> and a new Article 2A, Article 4A and Article 6 have been promulgated, the Official Text of Article 2 remains fundamentally the same.<sup>22</sup> In the Spring of 1988, however, the Permanent Editorial Board<sup>23</sup> and the American Law Institute, in conjunction with the National Conference of Commissioners on Uniform State Laws, approved a Study to consider whether Article 2 should be revised and, if so, to report on what revisions might be required. The charge to the Study Group was to identify "major problems of practical importance" in the interpretation and application of Article 2.<sup>24</sup> The Study also provides an opportunity to consider whether Article 2 is drafted as a coherent whole and contains the internal unity necessary to support its underlying policies and to achieve harmony with other Articles in the UCC.<sup>25</sup>

## B. DRAFTING ARTICLE 2: UNDERLYING POLICIES.

### 1. Drafting Dilemmas.

Grant Gilmore argued that the purpose of general commercial legislation should be to "clarify the law about business transactions rather than change

changes in remedies. See Symposium, Panel Discussion of the UCC-Report of the New York Law Revision Commission-Areas of Agreement and Disagreement, 12 Bus. Law. 49, 51 (1956). For a more focused discussion of the Commission's conclusions on Article 2, see Pasley, *Id.* at 59-60.

17. These recommendations, proposed in 1955, are reprinted in XVII Kelly 323-32. See also, *Id.* at 414-25.

18. XVIII Kelly 43-110.

19. XX Kelly 346 et seq.

20. Louisiana has now enacted all of the UCC except Articles 2, 2A and 6.

21. The main revisions were of Article 9 in 1972 and Article 8 in 1978. A revision of Articles 3 and 4 is scheduled for completion in 1990.

22. In 1966, § 2-702(3) was revised to delete the phrase "or lien creditor." In 1972, § 2-107(1) was revised to include "oil and gas" within the definition of minerals and § 2-107(2) was revised to add the phrase "or of timber to be cut." More recently, the PEB has published "commentary" on particular provisions, which is designed to clarify recurring disputes over proper interpretation.

23. The Editorial Board of the Uniform Commercial Code became the Permanent Editorial Board (PEB) in 1961.

24. For an excellent analysis, see Leary & Frisch, *Is Revision Due for Article 2*, 31 Vill. L. Rev. 399 (1986)(hereinafter *Revision*).

25. Professor (now Justice) Ellen Peters, writing in 1963, raised important questions about the coherence and unity of Article 2. In particular, she questioned the consistency between the sections dealing with performance of the contract and those dealing with remedies. See Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the UCC: A Roadmap for Article 2*, 73 Yale L.J. 199, 200-04 (1963)(hereinafter *Roadmap*).

the habits of the business community" and that the principal object of a draftsman is to be "accurate and not to be original."<sup>26</sup> Let us accept this as a working principle, even though we may deviate upon occasion. Since clarification and accuracy presuppose some knowledge about business "habits", two important dilemmas were posed for the drafters of Article 2.

First, it is hard to be accurate without knowledge of relevant practices. At the inception of Article 2 there was no fund of data systematically gathered to inform the drafters. Moreover, access to such data is complicated by the variety of contexts within which goods are sold and the different functions performed by sellers and buyers. One could expect different habits depending on whether the goods sold are race horses or computer software or natural gas or clothing or new automobiles or factory equipment or whether the seller is a jobber rather than a manufacturer or whether the buyer purchases for commercial consumption or resale or consumer consumption. In these overlapping contexts, actual business practices are difficult to identify and quantify, much less to evaluate.

Second, there are some "habits" of the business community that may need changing. Granted, the law of crimes, torts, antitrust, unfair competition and fraud is there to deter and punish egregious misconduct. Should, then, a commercial statute be concerned about bad habits that fall between the cracks and, if so, how does one determine what is bad and what remedies are appropriate? The question has particular relevance for disputes where the buyer is a consumer, i.e., an individual who purchases for personal, family or household purposes.

In the paragraphs to follow, we will briefly (1) examine how these drafting dilemmas were resolved in the 1958 Official Text of Article 2 and (2) recommend how a Drafting Committee might proceed in the revision of Article 2.

## 2. Underlying Policies.

Article 2, Sales, deals primarily with contracts for the sale of goods. Article 2 may cover other transactions in goods, either directly or by analogy, but the primary transaction is the sale.<sup>27</sup>

Within this transactional limitation, Article 2, aided by the general definitions and provisions of Article 1, avoids the first drafting dilemma by utilizing flexible standards, such as commercial reasonableness and good

---

26. Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 *Yale L.J.* 1341, 1341-42 (1948).

27. See § 2-106(1), which states that in Article 2 "unless the context otherwise requires 'contract' and 'agreement' are limited to those relating to the present or future sale of goods."

*faith, rather than rules that purport to capture and solidify prevailing practices and norms. Each dispute between a seller and buyer is placed in its functional setting where the parties are expected to find and prove relevant "habits," i.e., trade usage or practices, as part of the agreement.*<sup>28</sup> *Under these standards, the court is given flexibility (at some cost to certainty and administrability) to resolve the new or unique dispute. Moreover, standards are thought to reduce the gap between law and practice and to insure that decisions are practical and responsive to the needs, proven in the particular case, of the parties and the relevant business community.*<sup>29</sup>

*In addition to this emphasis upon standards and the rejection of "title" as a problem solving concept,<sup>30</sup> several other basic policies underlie the drafting approach in Article 2.*

*(a) Broad Scope and Effect of Agreement.*

*An underlying purpose of the UCC is to "permit the continued expansion of commercial practices through custom, usage and agreement of the parties. . . ." § 1-102(2)(b). This purpose<sup>31</sup> is implemented, in part, by a broad definition of agreement in § 1-201(3), and the delegation to the parties of power, albeit limited, to choose which state's version of Article 2 applies, § 1-105(1), and to vary "the effect of provisions of this Act. . . by agreement. . . ." § 1-102(3).*

*These provisions, supplemented by § 1-205, entitled "Course of Dealing and Usage of Trade," are relevant to a wide range of issues of liability and remedy arising under Article 2.<sup>32</sup> Thus, under Article 2, the expansible*

---

28. See § 1-201(3). Peters states, for example, that the performance obligation is stated in "terms of operative facts rather than legal conclusions." The emphasis is upon actual, provable circumstances within the control of the parties rather than upon rules within the control of the courts. Roadmap at 202.

29. Cf. Eisenberg, *The Responsive Model of Contract Law*, 36 Stan. L. Rev. 1107, 1109 (1984), who asserts that "law is. . . a purposive institution whose principles and theories are normative and prescriptive. . . [and that] contract is a social institution before it is a legal institution, and the rules of contract law must respond to the social institution, not to autonomous legal conventions."

30. § 2-401.

31. Section 1-102(1) provides that this "Act shall be liberally construed and applied to promote its underlying purposes and policies" and then, in § 1-102(2), states what those purposes and policies are.

32. Whether the agreement of the parties is in law a contract for sale is a separate question. See § 1-201(11), where "contract" is defined to mean the "total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law." Cf. § 2-106(1)(defining the scope of the phrase "contract for sale").

agreement of the parties, i.e., the "bargain in fact," rather than the promise provides the foundation stone of the transaction.<sup>33</sup>

One important consequence of this approach is that values and norms which are "imminent" in the relevant context may be extracted and applied by the court, whether they emerge in determining the agreement in fact of the parties or in filling "gaps" in that agreement.<sup>34</sup> In theory, at least, differences created by the types of goods sold and the economic roles played by the seller and buyer should emerge in the litigation process.

(b) *Application of Standards in the Absence of Agreement: "Gap" Filling.*

Article 2 may impose obligations on parties whose agreement is incomplete or omits material terms. There are no rules of offer and acceptance that state how much agreement must be reached before a contract exists. Rather, Article 2 provides flexible standards that depend upon (a) what the parties intended or (b) what they would have intended if they had considered it (the so-called "hypothetical" bargain.)

The "intention" test is illustrated by § 2-204(3), which provides that "even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy." Conduct by both parties which "recognizes the existence of such a contract" is the best evidence of intention. § 2-204(1). See § 2-207(3). If the requisite intention to conclude the bargain is not present, however, no contract is formed. Compare § 2-305(4). If the requisite intention is present, enforceability depends upon the certainty of the agreement. This, in turn, depends upon relevant facts derived from the commercial context.

The "hypothetical" bargain is illustrated by the provisions in Article 2, Part 3.<sup>35</sup> If the parties have intended to contract but have not agreed upon a particular term, the court is invited to supply a "reasonable" term to fill the "gap." Thus, if the price was not agreed, the parties are bound by a "reasonable price at the time for delivery." § 2-305(1).<sup>36</sup> The

---

33. See, e.g., Murray, *The Article 2 Prism: The Underlying Philosophy of Article 2 of the Uniform Commercial Code*, 21 Washburn L. J. 1 (1981); Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 Vill. L. Rev. 213 (1966).

34. See Danzig, *Comment on the Jurisprudence of the Uniform Commercial Code*, 27 Stan. L. Rev. 621 (1975). See also, Gedid, *U.C.C. Methodology: Taking A Realistic Look at the Code*, 29 Wm & Mary L. Rev. 341 (1988).

35. See also § 1-204, which concerns the requirement of "reasonable" time.

36. If a reasonable price is not established, the contract fails for indefiniteness. § 2-204(3).



assumption here is that the appropriate norms, i.e., the "situation sense," can be derived from the surrounding commercial context.<sup>37</sup> Consistency with a consent based theory is maintained by assuming that the "off the rack" terms would have been agreed to if considered by the parties.<sup>38</sup>

(c) The "Merchant" Standards.

With few exceptions, Article 2 does not differentiate between sellers and buyers, whether they are in commercial or consumer transactions. That exception concerns transactions involving or "between"<sup>39</sup> "merchants," as that person is defined in § 2-104(1). In these situations, different or higher standards bind the merchant than those applicable to others. For example, only a merchant seller can make a firm offer, § 2-205, or an implied warranty of merchantability, § 2-314(1). In addition, merchants have a higher duty of good faith, § 2-103(1)(b), and greater power to pass good title § 2-403(2), and may ignore certain writings at their peril, §§ 2-201(2) & 2-207(2).

The "merchant" standards, which are limited to Article 2, have been subjected to extensive analysis and evaluation.<sup>40</sup> Despite questions about their origins and effect, they reflect a common sense judgment about the responsibilities of persons involved in commerce. As one commentator put it, "it may be said that what's good for businessmen in Article 2 is good for the rest of us."<sup>41</sup> Nevertheless, one can question whether this endorsement should apply to consumers or whether the "merchant" standards should be applied to other articles of the UCC.

37. See Gedic, *supra* Note 34 at 361-71, discussing Llewellyn's approach to commercial law. See also, Restatement, Second, Contracts § 204 which provides: "When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court."

38. But see Ayres & Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L. J. 87 (1989)(questioning conventional justifications for "gap filling").

39. See § 2-104(3).

40. See, e.g., Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 Harv. L. Rev. 465 (1987)(arguing that because Llewellyn did not accomplish all that he intended in the drafting process, the "merchant" rules in Article 2 emerged in a patchwork and sometimes incoherent fashion).

41. Hillinger, *The Article 2 Merchant Rules: Karl Llewellyn's Attempt to Achieve the Good, the True and the Beautiful in Commercial Law*, 73 Geo. L.J. 1141, 1176-80 (1985).

(d) *Legal Controls on the Agreement: Unconscionability and Good Faith.*

Two important limitations upon the "bargain in fact" are the requirement that a contract or clause not be unconscionable "at the time it was made," § 2-302(1), and the imposition of an obligation of good faith on the "performance or enforcement" of every contract or duty with the UCC. § 1-203.

The conscionability requirement is imposed by and apparently limited to Article 2. It operates, primarily, at the time of contracting<sup>42</sup> to protect one party from bargaining abuses that are not otherwise regulated by the doctrines of fraud, duress or mistake. Despite early criticism of § 2-302,<sup>43</sup> the courts have exercised restraint in identifying what has been called "procedural" unconscionability<sup>44</sup> in both consumer and commercial transactions.<sup>45</sup>

The duty of good faith is imposed in Article 1, see § 1-203, and is elaborated in Article 2 through a higher, objective standard of good faith for merchants. § 2-103(1)(b). It operates, primarily, after the contract has been formed. Despite acceptance of the duty in general contract law,<sup>46</sup> there is continuing disagreement about such questions as the scope of duty, what conduct constitutes bad faith and the remedies that are available when bad faith is established.<sup>47</sup>

Despite their statutory origins, both limitations now find wide acceptance in general contract law.

*Rec. Int. (1)*

The Study Group endorses the drafting style utilized in Article 2 and recommends that the general sales policies, discussed above,

---

42. But see Kniffin, *A Newly Identified Contract Unconscionability: Unconscionability of Remedy*, 63 *Notre Dame L. Rev.* 247 (1988)(court should consider effect of agreed remedy at time of breach).

43. A classic critical article is Leff, *Unconscionability and the Code: The Emperor's New Clause*, 115 *U. Pa. L. Rev.* 485 (1967). For more balanced assessments, see Ellinghaus, *In Defense of Unconscionability*, 78 *Yale L. J.* 757 (1967); Spanogle, *Analyzing Unconscionability Problems*, 117 *U. Pa. L. Rev.* 931 (1969). See also, Hillman, *Debunking Some Myths About Unconscionability: A New Framework for U.C.C. Section 2-302*, 67 *Cornell L. Rev.* 1 (1981).

44. See Epstein, *Unconscionability: A Critical Reappraisal*, 18 *J. Law & Econ.* 293, 315 (1975)(distinguishing between defects in the process of contract formation ("procedural") and complaints about the substance of the terms included in the apparent bargain ("substantive").

45. See Mallor, *Unconscionability in Contracts Between Merchants*, 40 *Sw. L.J.* 1065 (1986).

46. See *Restatement, Second, Contracts* § 205.

47. An important article is Summers, *Good Faith in General Contract Law and the Sales Provisions of the UCC*, 54 *Va. L. Rev.* 195 (1968). For a recent application, see Andersen, *Good Faith in the Enforcement of Contracts*, 73 *Iowa L. Rev.* 299 (1988).

*be retained. There is little evidence that these policies have interfered with commerce by creating an unacceptable level of uncertainty for the parties or administrative costs for the courts. Rather, the policies appear to establish a commendable balance between facilitation (efficiency) and regulation (fairness) in contracts for sale where neither party is a consumer. Above all, they delegate power to the parties to fashion their own agreement.*

*We recommend that the Drafting Committee consider ways beyond those recommended by the Study Group to articulate these policies and to improve their implementation. The objective is to achieve a more complete utilization of them by the parties and the courts in the resolution of commercial disputes.*

### C. CONSUMER PROTECTION.

*A second drafting dilemma concerns the extent to which a commercial statute should attempt to deter or alter the conduct of persons engaged in a trade or of parties to the contract for sale. The Article 2 solution is to invoke general standards to reject commercially unreasonable practices,<sup>48</sup> avoid unconscionable contracts or clauses and treat bad faith performance or enforcement as a breach of contract regardless of who the parties are. Beyond that, Article 2 is neutral when direct issues of regulation are posed. There are no special provisions designed to provide protection to a consumer buyer in transactions with a merchant seller.<sup>49</sup> Rather, § 2-102 simply provides that Article 2 does not impair or repeal "any statute regulating sales to consumers, farmers or other specified classes of buyers."*

*Since the 1958 Official Text was approved, there have been numerous important developments in consumer protection on both the federal and state level. They include the increased regulation of both credit and sales practices, as well as the content of the consumer contract for sale and the growth of state "little" FTC Acts which are invoked in both consumer and commercial transactions.<sup>50</sup> There are, however, noticeable gaps in coverage where Congress*

---

48. See Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the UCC*, 30 U. Chi. L. Rev. 666 (1963).

49. § 2-103(3) incorporates for Article 2 the definition of "consumer goods" found in § 9-109(1). § 2-719(3), dealing with the validity of clauses limiting consequential damages "for injury to the person in the case of consumer goods," is the only substantive section of Article 2 that mentions consumer goods.

50. See, generally, Macaulay, *Bambi Meets Godzilla: Reflections on Contracts Scholarship and Teaching vs. State Unfair and Deceptive Trade Practices and Consumer Protection Statutes*, 26 Hous. L. Rev. 575 (1989); Lawrence, *Toward a More Efficient and Just Economy: An Argument for Limited Enforcement of Consumer Promises*, 48 Ohio St. L.J.

or the FTC has failed to go far enough and other state legislation is incomplete or non-existent. For example, many states either have failed to enact comprehensive consumer protection legislation or have enacted legislation, such as the "lemon" laws, that does not fill the gaps in coverage under the Magnuson-Moss Warranty Act. This result has been criticised by some commentators.<sup>51</sup>

*Rec. Int. (2)*

Despite these gaps in coverage and the decision in Article 2A to provide special protection in some cases to consumer lessees,<sup>52</sup> the Study Group makes the following recommendations to the Drafting Committee:

(A) The revised Article 2 should neither incorporate more comprehensive consumer protection legislation than already enacted apart from the UCC nor contain new sections specially drafted to fill apparent gaps. The responsibility for enacting comprehensive consumer protection legislation should be located outside of the scope of general commercial legislation;

(B) The Drafting Committee should consider whether the limited, special consumer protection provisions in Article 2A are appropriate for inclusion in a revised Article 2;

(C) The Study Group, in the Report to follow, will consider whether limited affirmative rules for consumers are appropriate in certain areas now covered by Article 2, e.g., the scope of warranties, disclaimers and limited remedies or the content of unconscionability and good faith, and make recommendations to the Drafting Committee;

(D) Section 2-102 should be revised to state that subject to any statute or decision which establishes a different rule for seller or

---

815 (1987); Blumberg, *Consumer Protection in the United States: Control of Unfair or Unconscionable Practices*, 34 Am. J. Comp. L. 99 (Supp. 1986); Coffinberger & Samuels, *Legislative Responses to the Plight of New Car Purchasers*, 18 U.C.C. L.J. 168 (1985); Note, *Examining Restraints on Freedom to Contract as an Approach to Purchaser Dissatisfaction in the Computer Industry*, 74 Calif. L. Rev. 2101 (1986); Note, *Revising the Law of Substantive Unconscionability: Applying the Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts*, 33 UCLA L. Rev. 940 (1986).

51. See generally, Rice, *Product Quality Laws and the Economics of Federalism*, 65 B.U.L. Rev. 1 (1985).

52. See Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 Ala. L. Rev. 957 (1988). Article 2A contains a "limited" number of express consumer protection provisions. *Id.* at 964-74.

*buyers of consumer goods, the provisions of Article 2 shall apply.*<sup>53</sup>

## [TASK FORCE - INTRODUCTION]

### I. REVISION OR CLARIFICATION THROUGH THE USE OF CODE COMMENTS

The Preliminary Report is replete with instances where revision or clarification of Uniform Commercial Code ("Code") Comments is the recommended method for solving a particular Code problem. The Task Force strongly believes that an attempt must be made to formulate and apply a workable standard for determining when it is appropriate to proceed by redrafting the commentary and when the revision or clarification should be reflected in the language of the statute itself. Admittedly, the formulation of the requisite standard is not an easy matter.

The function of the Comments as conceived by Professor Llewellyn was to assist the courts in their application of the Code by providing an authoritative guide to the purposes and reasons for each section. To what extent the Comments have, in fact, influenced decision-making is far from clear. Part of the difficulty stems from the divergent opinions surrounding their use and authoritativeness. Despite the frequently encountered view that the Comments are persuasive but not binding,<sup>1</sup> it is not unusual to find that they were not followed in a case either because it was thought that their application would lead to an inappropriate result,<sup>2</sup> or would effectively vary the plain language of the statute.<sup>3</sup> Consider also the situation in Colorado where a statute provides that "[t]he inclusion of said nonstatutory matter [the Comments] shall be for the purpose of information and no implication or presumption of legislative intent shall be drawn therefrom."<sup>4</sup>

A further complication results from the failure of many courts to state with a sufficient degree of clarity why a particular Comment is or is not being followed. Consequently, it may be difficult to

---

53. Cf. § 2A-104, which states to types of statutes to which a lease might be subject and provides a rule to determine which statute controls in the event of conflict.

1 See, e.g., *Bickett v. W.R. Grace & Co.*, 12 U.C.C. Rep. Serv. (Callaghan) 629, 642 (W.D. Ky. 1972).

2 See, e.g., *Consolidated Film Indus. v. United States*, 547 F. 2d 533, 536-37 (10th Cir. 1977).

3 See, e.g., *Wright v. Bank of Cal.*, 276 Cal. App. 2d 485, 490, 81 Cal. Rptr. 11, 14 (1969).

4 COLO. REV. STAT. § 2-5-102(4) (1989).

tell how that very same court will treat the Comments in the future.

Accordingly, legislation by comment may or may not bring about the changes and clarifications recommended by the Study Group. The indiscriminate use of the Comments as a tool of change militates against uniformity and therefore should be abandoned. In his fine article on the Comments, Professor Skilton observed that they may be "(1) expository—seeking to describe the meaning and application of a section of the Code and its relationship with other sections, (2) gap-filling—seeking to suggest answers to questions not precisely covered by the text, or (3) promotional and argumentative—seeking to 'sell' a controversial section."<sup>5</sup>

It is the second mentioned function of the Comments which has the potential to cause the most difficulty. To borrow again from Professor Skilton, "[w]e cannot ask the comments to do the work that should be done by the text."<sup>6</sup> It seems that if disagreement on a particular point would be harmful to the uniform application of the Code, that point should be dealt with in the text. It makes no sense, for example, to define a term in the Comments if, as a result, that definition is ignored or modified by the courts.

At least one Task Force member believes that nothing should be done by way of comment unless the accompanying text is also being changed. As he sees it, comments clarify the author's meaning in the accompanying text; consequently, it is not proper to write any comments at this time to explain which text is not also being modified. Thus, the key is not to find a workable distinction between "clarifications" and "substantive changes," presumably allowing the former to be done by new comments on the old text. Such a distinction will prove elusive at best. However, where new statutory text is being added, clarifications of the new parts may be made by comment.

For these reasons, the Task Force strongly believes that a more cautious approach to the Comments is needed.

## II. THE SUBSTANTIVE COVERAGE OF ARTICLE 2

The need to reconsider the scope of Article 2 is a theme that has pervaded the dialogue of revision. In particular, with the

---

<sup>5</sup> Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 WIS. L. REV. 597, 608.

<sup>6</sup> *Id.* at 614.

promulgation of Article 2A, the common perception of the scope problem now centers around the extent to which Article 2 should apply to contracts with a service component.<sup>7</sup>

The Study Group apparently includes in that category the incredible panoply of problems flowing from the explosion of computer technology, but leaves the distinct impression in a footnote that those issues should be left to a different Study Group already created under different auspices.<sup>8</sup> It is difficult to see how an Article 2 revision could successfully finesse the issues in that way. No matter what emanates, if anything, from the other work, many computer-related transactions will still so affect sales matters as to necessitate some application of Article 2. The issues are too inter-related and important not to be considered in any revision of Article 2.

The Study Group Report's focus on existing sections also lacks any inquiry into such matters as including within a new Article 2 those areas of contract law on which the Code is presently silent.

In preparing this appraisal, the issue of coverage was approached from two angles. First, an attempt was made to form some general impressions about the extent to which courts have relied on certain non-Code doctrines in deciding cases involving the sale of goods. The second angle involved the question of whether the information learned would help explain why some pre-Code doctrines were codified and others were not. Therefore, the subjects selected for this informal empirical study were doctrines which are closely related to existing Code doctrines. They include the law of contract beneficiaries, mistake, and frustration of purpose. The frequency of application of each doctrine was determined by reference to judicial citation of Restatement sections found in the appendices to the Restatement (Second) of Contracts.

The initial choice for inclusion in this study was the third-party beneficiary doctrine. This was particularly attractive because the Code not only contains provisions pertaining to a conceptually related doctrine,<sup>9</sup> but does in fact deal with some aspects of the

---

7 See U.C.C. § 2-102 (1990) (stating that the scope of Article 2 applies *only* to transactions in *goods*).

8 Prelim. Rpt., Part 1 n.5 and accompanying text, *infra* p. 1010.

9 The law of assignments also deals with the rights of third persons who were not parties to the original contract. But unlike the third-party beneficiary, the assignee acquires its rights subsequent to the contract's formation. See, e.g., U.C.C. §§ 2-210 & 9-318 (1990).

beneficiary problem. For example, section 2-318 offers three alternative approaches to the extension of warranty liability to third parties, and section 2-210 touches on the enforceability of an assignee's promise to perform the assignor's duties.<sup>10</sup> According to this study, there were no less than 19 sales cases that cited one or more sections of the Restatement or Restatement (Second) for an aspect of third-party beneficiary law on which the Code is silent.<sup>11</sup>

Although the Code explicitly recognizes the doctrine of impracticability of performance,<sup>12</sup> it says nothing of the doctrine of frustration of purpose although the two share a common conceptual base, that is, both deal with erroneous forecasts of the future. In twelve instances, frustration was argued in a sale of goods case with citation to either the First or Second Restatement.

Of greater quantitative significance is the doctrine of mistake. Mistake is characterized as a related doctrine because it, too, qualifies or excuses performance on the ground that one or both parties erred in their assumptions. In all, there were seventeen cases in which this doctrine was referred to.

These findings about the frequency of citation to the Restatements and non-Code law are not surprising. Both as a practical and a political matter, the coverage of the Code must be limited to some degree. It is inevitable, therefore, that contract litigation will occasionally implicate law that is external to the Code. This is not meant to suggest, however, that the choices made are inconsequential. To the extent that outside law is controlling, the goals of the Code are jeopardized. For example, the exclusion of mistake from the Code leaves (as this empirical survey suggests) a substantial gap in the Code's coverage of the law of mistaken assumptions. This is especially troubling where the gap must be filled by unpredictable law that is subject to competing tensions—the desire for commercial stability and sympathy for a mistaken

---

10 See U.C.C. § 2-210(4) (1990).

11 See, e.g., *United States v. Pall Corp.*, 367 F. Supp. 976, 980 (E.D.N.Y. 1973) (citing RESTATEMENT OF CONTRACTS § 133 (1932) for the general rule that a person may claim as a third party beneficiary if the performance of a promise will satisfy a duty of the promisee to the beneficiary); *United States v. Glassman Constr. Co.*, 266 F. Supp. 110, 115 (D. Md. 1967) (citing RESTATEMENT OF CONTRACTS § 140 for the proposition that a third party beneficiary can acquire greater rights against a promisor than the promisee).

12 See U.C.C. § 2-615 (1990).



contract party.<sup>13</sup> Furthermore, the potential for confusion is further exacerbated by the inherent indeterminacy of U.C.C. section 1-103.<sup>14</sup>

It is not suggested that the law of mistake or any other particular doctrine should be added to a revised Article 2. The point is rather that greater attention should be paid to how complete a statement the Code should make on the law of sales, and that the volume of cases involving non-Code law is a source of useful information in this regard. It remains to be determined, however, how heavily this information should be weighed. The fact is that having this information would strengthen whatever decisions are ultimately made.

### III. CONSUMER CONSIDERATIONS

#### A. *The Recommendations Regarding Consumer Provisions*

There is a degree of ambivalence about the Study Group's recommendations pertaining to consumers. On the one hand, there is a clear attempt to declare neutrality. This begins with the assessment that the general policies of Article 2 "establish a commendable balance between facilitation (efficiency) and regulation (fairness) in contracts for sale *where neither party is a consumer*."<sup>15</sup> It continues with the recommendation that "[t]he revised Article 2 should neither incorporate more comprehensive consumer protection legislation than already enacted apart from the UCC nor contain new sections specially drafted to fill apparent gaps. The responsibility for enacting comprehensive consumer protection legislation should be located outside of the scope of general commercial legislation."<sup>16</sup>

On the other hand, the Report, early on, acknowledges "numerous important developments in consumer protection on both

---

13 Newman, *Relief for Mistake in Contracting*, 54 CORNELL L. REV. 232, 237 (1969). The risk of inconsistent decisions in this area is due in part to the dichotomy in Anglo-American law between the desire for stability of commercial transactions on the one hand, and concern over the unfairness of enforcing a contract against a party who lacked complete information regarding all the relevant circumstances. *Id.* at 236-37. This problem of inconsistency is compounded by the fact that the Second Restatement contains a significantly different articulation of the doctrine than that contained in the first.

14 See *infra* pp. 1010-12 and text accompanying notes 48-51.

15 Prelim. Rpt., Introduction, Rec. Int. (1), *supra* p. 993-94 (emphasis added).

16 Prelim. Rpt., Introduction, Rec. Int. (2)(A), *supra* p. 995.

the federal and state level” implemented after Article 2 was drafted, and that there are “noticeable gaps in coverage where Congress or the FTC has failed to go far enough and other state legislation is incomplete or non-existent.”<sup>17</sup> The Study Group also recommends that the Drafting Committee consider whether the special consumer protection provisions included in Article 2A “are appropriate for inclusion in a revised Article 2,”<sup>18</sup> and that Section 2-102 be revised to state that “subject to any statute or decision which establishes a different rule for sellers or buyers of consumer goods, the provisions of Article 2 shall apply.”<sup>19</sup> Moreover, the disagreements within the Study Group regarding disclaimers, parol evidence and privity often implicate consumer issues. Finally, the Study Group recommends that the Drafting Committee “identify” gaps in consumer protection not covered by Article 2, and possibly include a reference to them in a comment.<sup>20</sup>

The result of this somewhat intricate minuet is somewhat questionable and even debatable. While there seems to be agreement on the general proposition that a commercial code by definition is not to deal with consumer matters, there also appears to be enough concern about specific issues that impact consumers to at least warrant affixing warning labels on some Official Comments, along with a more splintered interest in fashioning “limited” affirmative rules in the statute.

Left out of all this, or at least not articulated, is a persuasive policy basis for one side or the other. To some extent, this is quite understandable, perhaps inevitable, in view of the kind of document and task involved. Consumer laws *are* controversial,<sup>21</sup> and there were many more digestible fish to fry. But before a Drafting Committee is in place, serious consideration should be given to the possibility of confronting at least some consumer problems in the warranty area and providing expressly for them in the revised “commercial” code.<sup>22</sup>

---

17 Prelim. Rpt., Introduction, *supra* p. 994-95.

18 Prelim. Rpt., Introduction, Rec. Int. (2)(B), *supra* p. 995.

19 Prelim. Rpt., Introduction, Rec. Int. (2)(D), *supra* p. 995-96.

20 Prelim. Rpt., Part 1, Rec. A2.3(6), *infra* p. 1082-83.

21 Part of the folklore some recall about Article 2 is that the drafters chose not to include more consumer provisions out of the political concern of arousing lobbies which might threaten enactment of the Code.

22 The only provisions in the current Article 2 which refer to consumer matters are those in §§ 2-318 and 2-719(3) which, in effect, establish some rules

*B. Some Preliminary Reasons To Include Express Consumer Provisions*

1. Impact on Case Law

To begin with, although the language of the current Article 2 is consumer neutral, the case law is not. Consumer cases have played an important role in the development of Article 2 case law involving warranties and remedies for breach of warranties. Perhaps the most prominent of these is that dealing with failure of essential purpose (section 2-719(2)). Identification of one or more sections in which consumer cases have colored the interpretations is not really necessary. Consumer issues will always put pressure on more general law unless there is some pre-emptive consumer law applicable to the situation. In the early days of the Code, the pressures started on disclaimer issues; it was some years before failure of essential purpose was reached. But consumers got there, and the law continues to bear their mark.

To say the Code will be "neutral" to consumers cannot overcome the fact that it will continue to apply to consumer sales transactions. No one, after all, is proposing that the "commercial" code *not* apply to consumer transactions. If there is no applicable "consumer" law, a "commercial" code court will be tempted to make some by interpretation—thereby implicating all the stare decisis problems associated with that process.

In an ironic way, one of the provisions recommended by the Study Group could help overcome that problem. Section 2-102 would be revised to state that "subject to any statute or decision which establishes a different rule for sellers or buyers of consumer goods, the provisions of Article 2 shall apply." The change from the present text is underscored: the revised provision seems to authorize courts to promulgate different rules for consumer transactions. If courts did so with appropriate labels, the "commercial" code would not be sullied. Of course, such a statute provides absolutely no guidance, and if the provision is construed to authorize courts to develop their own consumer law and depart from

---

limited to cases of personal injury of consumers. *See also* § 2-607 comments 4, 5. The Study Group, incidentally, recommends removal of these provisions in the interests of drawing proper boundaries between sales warranties and strict liability in tort.

Article 2 simply because the transaction involves a consumer, all hopes for uniformity become sheer pretense.

## 2. Lack of Consumer Sales Law

There is not available a viable package of non-U.C.C. law to resolve consumer sales law problems. The federal Magnuson-Moss Act is in most respects a disclosure statute, although it carries with it significant substantive provisions (referred to below) limiting implied warranty disclaimers and broadening the class of those legally entitled to assert breach of warranty claims. Clearly the federal law does not purport to provide sales law *per se*.

Despite the prevalence of little FTC Acts (although in different forms) and the explosion of cases in recent years, it is clear that not all consumer disputes are covered. In some states, it is clear, for example, that pure warranty cases are not covered;<sup>23</sup> in others, "private" disputes are not covered.<sup>24</sup> Texas, as usual, is exceptional; its statute expressly applies to sales warranty actions.<sup>25</sup> On the other hand, it is ironic that "consumer" is construed in some states to include commercial parties.<sup>26</sup> In those states, deferring consumer protection to little FTC Acts would result in no differentiation at all between consumers and commercial parties.

So-called "lemon" laws do not purport to be comprehensive sales laws.<sup>27</sup> They focus specifically on remedies available for breach of warranty. However, they generally assume the existence of warranties and provide no rules for creation, limitation or disclaimer. Moreover, most apply only to new passenger cars.<sup>28</sup> Thus,

---

23 See, e.g., NATIONAL CONSUMER LAW CENTER, UNFAIR AND DECEPTIVE TRADE PRACTICES § 5.2.7.1 (2d ed. 1982 & Supp.).

24 *Id.* § 7.5.2. See also McDonald, *The Applicability of the Illinois Consumer Fraud and Deceptive Business Practices Act to Private Wrongs*, 39 DEPAUL L. REV. 95, 96-97 (1989).

25 TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (Vernon 1987).

26 See, e.g., UNFAIR AND DECEPTIVE TRADE PRACTICES, *supra* note 23, § 2.4.4; D. PRIDGEN, CONSUMER PROTECTION AND THE LAW § 4.02[1] (1989).

27 See generally R. BILLINGS, HANDLING AUTOMOBILE WARRANTY AND REPOSSESSION CASES (1984); Vogel, *Squeezing Consumers: Lemon Laws, Consumer Warranties, and a Proposal for Reform*, 1985 ARIZ. ST. L.J. 589; NATIONAL CONSUMER LAW CENTER, SALES OF GOODS AND SERVICES § 34 (2d ed. 1989); PRIDGEN, *supra* note 26, ch. 15.

28 In the following state codes, there is some coverage of used cars: N.Y. GEN. BUS. LAW § 198-b (McKinney 1988); R.I. GEN. LAWS § 31-5.5 (1982 & Supp. 1990); MASS. GEN. LAWS ANN. ch. 90, § 7N 1/4 (West 1989); MINN. STAT. ANN. § 325F.662 (1990); CONN. GEN. STAT. § 42-220 (1987).

while (from the perspective of the consumer) they provide both a more bright-line form of remedy than Article 2 and an impetus for resolution of warranty claims, in the larger perspective, they are merely a remedy add-on to Article 2 for a limited class of products.

### 3. Consistency With the National Policy Established by the Magnuson-Moss Act

Consideration must be given to whether a revised Code should be textually consistent with the national policy established in the Magnuson-Moss Act. Implicitly, the answer of the Study Group is "no." The Study Group does contemplate that the act is one of those laws to which reference might be made in a revised section 2-102,<sup>29</sup> and perhaps in warning label comments to other sections.<sup>30</sup> But it makes no explicit reference to the act other than to note the difference between the current Article 2 and the act's definition of "consumer product."<sup>31</sup>

In view of the fact that Article 2 will continue to apply to consumer transactions, even if on a "consumer-neutral" basis, does it really make sense to acknowledge only in the comments that the implied warranty of merchantability cannot be disclaimed in any transaction involving consumer goods where there is a written warranty? Additionally, does it make sense that the Magnuson-Moss Act flexibly jumps both horizontal and vertical privity hurdles in a single bound.<sup>32</sup>

Even if one cavils at the thought of cross-referencing a federal act in a state uniform law, at the very least express consideration ought to be given to whether that state law should express the controlling federal position. Perhaps such consideration supported some of the Study Group disagreement regarding privity and merchantability issues.<sup>33</sup> More explicit consideration is required. How can we ignore controlling law?

---

29 Prelim. Rpt., Introduction, Rec. Int. (2)(D), *supra* p. 995-96.

30 Prelim. Rpt., Part 3, Rec. A2.3(6), *infra* p. 1082-83.

31 The Study Group's recommendation that the definitional difference be considered by the Drafting Committee is meaningless in view of its recommendations that all current Article 2 references to consumer goods be deleted. *See* Prelim. Rpt., Part 3, Rec. A2.3(8), *infra* p. 1083.

32 Whether the Magnuson-Moss (anti) privity provisions apply in the absence of a written warranty is considered below.

33 Prelim. Rpt., Part 3, *infra* p. 1113-14.

Consideration should not be only on the grounds that there happens to be federal law governing these issues. The fact that there is such law should require re-examination of the policies underlying that law, e.g., whether implied warranty disclaimers should be banned. Not only has there now been some years of experience under the Magnuson-Moss Act, but there is also experience in a number of states which have, in some instances, gone even further.<sup>34</sup>

Finally, it is worth noting that the Magnuson-Moss Act will apply even in merchant transactions so long as the subject matter of the sales contract is a consumer *product* as defined in the act.<sup>35</sup> Thus, the impact of the law is not limited to consumer transactions.

#### 4. Reconsideration of Adhesion Contract Issues

Finessing consumer issues also sidesteps several extremely basic issues that require periodic reconsideration: (a) Isn't it time to try to deal in a statutory way with the adhesion contract? (b) Given the enormous changes in marketing and merchandising since World War II, shouldn't there be some revision of our approaches to warranty and privity issues?

It is, of course, old hat that statutory provisions still relate to the paradigm bargain transaction from which sales law originally arose—the two horse traders bargaining over a horse in what was literally a hands-on transaction. The warranty of description at least recognized that special protections were necessary when the goods were not at hand (or underhand). Since then little has been done to break away from the eye-ball bargain paradigm. The statutory rules on disclaimers do not change the situation; they operate on the premise that there is a bargain being struck by two parties and simply provide a few guidelines on how the “bargaining” on that point is to be conducted.

The typically colorful observations of the late Professor Leff set the stage for reconsideration:

Contract seems to presuppose not only a deal, but dealing. It is the product of a joint creative effort. At least classically, the idea seems to have been that the parties combine their impulses and desires into a resulting product

---

<sup>34</sup> The jurisdictions are identified in NATIONAL CONSUMER LAW CENTER, SALES OF GOODS AND SERVICES, § 17.3.13 (2d ed. 1982 & Supp. 1990).

<sup>35</sup> 15 U.S.C. § 2301(1) (1990).

which is a harmonization of their initial positions. What results is neither's will; it is somehow a combination of their desires, the product of an ad hoc vector diagram the resulting arrow of which is "the contract."<sup>36</sup>

In the old horse-trade deal, what the parties left out of their spoken bargain "was covered by statute, custom or legal implication."<sup>37</sup> By contrast, in many modern deals, what was not discussed is covered by a document prepared by one of the parties.<sup>38</sup>

Over time, scholars grappled with the new problems and

created from the residuary category "contracts," the new subcategory "contracts of adhesion." Their basic insight was a simple and elegant one: there is a critical difference between a bargaining process and an on-off light switch. In the typical consumer-goods deal, for instance, the consumer must take the whole deal (or most of it) as a deal, or leave it, all of it.<sup>39</sup>

The adhesion contract theorists "detected the non-process nature of some 'contracts' (including consumer transactions) and thus created, so they thought, a new category, roughly speaking 'that which would be a contract except that no bargaining process really shapes it.'"<sup>40</sup> As Professor Leff sees it, the bargaining process in these transactions is

over two things, price and standard variations in the product. In fact, there is only one element of the deal that has not been the subject of any contracting process: the contract. And what does that look like? It looks like a contract. But when one stands far enough back from the whole deal, from the whole process of goods buying, what one sees is a unitary, purchased bundle, of which the product, say a car, is just the most tangible (and, oddly enough, the *most* mutable) thing. One goes out and acquires the whole "set" which is a "deal on a car," and of the interchangeable subsets (object, extras, con-

---

36 Leff, *Contract as Thing*, 19 AM. U.L. REV. 131, 138 (1970).

37 *Id.* at 140.

38 *Id.*

39 *Id.* at 142.

40 *Id.* at 143 (quoting "adhesion contract theorists").

tract), it is in fact arguable that the contract is *more* of a "thing" than the goods which are sold pursuant to it.

\* \* \*

[T]he *key* insight about "contracts of adhesion" was that they were products of non-bargaining, unilaterally manufactured commodities. Because as a thing, an object, it looks like the referent of the *noun* form of the word "contract;" it looks the way the *product* of the process of bargaining so often looks. What happened, it seems to me, is that of all the indicia which determine whether a thing is a contract or not, the most irrelevant—the physical appearance of the thing as a thing—turned out to be the most powerful. This thing, the consumer contract, just happens to look like the result of what in the consumer-contract context is a nonhappening,<sup>41</sup> the consumer contracting process.<sup>42</sup>

Professor Rice has briefly and well described changed market and marketing conditions:

The principal structural and organizational attributes of contemporary consumer goods markets and marketing are mass production, mass distribution, mass merchandising, and mass advertising. While mass production also characterized past eras, mass distribution, merchandising, and advertising are largely features of the post-1950 period.

\* \* \*

Mass merchandising also implies mass contracting; and the recent emergence of the broad use of retail store, national and bank credit cards accentuates the standardized, mass credit trend that developed with the growth and general availability of consumer installment sale and loan credit. In essence, with increased variety and abundance of consumer goods has come the standardization of transactions and the bureaucratization of market structure and institutions. In this lies both the supreme irony and the lesson of the marketing revolution; to wit, vastly

---

41 "It is even more ironic, perhaps, that even to the extent that there *is* a happening leading to the consumer contract, it is in any event to a large extent shielded from effective judicial scrutiny by the vestigial parol evidence rule." Leff, *supra* note 36, at 147 n.54. This particular problem is considered by the Study Group. See Prelim. Rpt., Part 2, *infra* p. 1043-44; Prelim. Rpt., Part 3, *infra* p. 1106.

42 Leff, *supra* note 36, at 146-47 (footnotes omitted).



greater opportunities to satisfy highly personal or individual material and nonmaterial wants come at the cost of personalized or individualized contacts and contracts.<sup>43</sup>

More recently, Professor Rice referred to the

marked contrast between the structure and orientation of the decisionmaking institutions and processes of the national consumer goods market and the fifty-state legal system. [M]uch more than the tension between national markets and state regulation [is involved. A study of privity rules] demonstrates the existence of fundamental differences in perspective by juxtaposing the functional emphasis of markets on producer-to-consumer distribution and the formalistic focus of the law on contractual relationships. The contrast reflects . . . the preservation in law of a traditional and formalistic model of market transactions despite the occurrence of significant changes in consumer goods marketing and markets.<sup>44</sup>

The logic of these observations leads to the conclusion that the focus should be not on the bargaining process but on the product.<sup>45</sup> In the context of warranty, that is minimal quality protection. The clearest candidates are an implied warranty of merchantability that cannot be disclaimed and broad standing to assert claims for manufactured goods. It would seem also to extend to remedies in the event of failure of essential purpose of a limited remedy.

There has already been experimentation in some states with disclaimer bans<sup>46</sup> which can be added to the results under the Magnuson-Moss Act. Moreover, it has been pointed out that the

---

43 D. RICE, CONSUMER TRANSACTIONS 12-13 (1975).

44 Rice, *Product Quality Laws and the Economics of Federalism*, 65 B.U.L. REV. 1, 21 (1985) (footnotes omitted).

45 Professor Leff was explicit about this:

[T]he critical strategic decision seems to be between deal control and goods control. . . . Now, keeping in mind the nature, factual and legal, of the usual consumer-goods (or services) transaction, deal control is ordinarily a stupid option; it is silly to seek to shape and control the contours of a process that does not take place. [H]ow does one go about regulating the contract as a process. [sic] By facilitating more bargaining? But that is absurd . . . ."

Leff, *supra* note 36, at 148.

46 See *supra* note 34 and accompanying text.

costs of such consumer laws are borne not just by those states which adopt them but also by those who adhere to the classic tradition.<sup>47</sup>

[PRELIMINARY REPORT - 1-103]

**ARTICLE 1:  
RELEVANCE TO ARTICLE 2**

**A. INTRODUCTION.**

*The general provisions of Article 1 are important to the proper interpretation and application of Article 2, as well as other Articles of the UCC. Some of these general provisions have a closer relationship to Article 2 than others. For that reason, a review of selected provisions in Article 1 is necessary, even though we do not provide a systematic analysis of the entire Article. That analysis, although needed, must await another day.*

*In this section, we tried to identify those provisions of Article 1 where, in the light of Article 2, revisions are indicated. Also, we recommend at least two new provisions for Article 1 and the possible transfer to Article 1 from Article 2 of at least one other provision.<sup>1</sup>*

*This Report does not consider the impact of electronic messaging systems upon the Article 1 definitions. This important development, as well as the impact on Article 2 itself, is covered in a separate report by the Electronic Messaging Services Task Force of the Committee on Uniform Commercial Code of the American Bar Association.<sup>2</sup>*

**B. SUPPLEMENTARY GENERAL PRINCIPLES OF LAW  
APPLICABLE: § 1-103.**

*Grant Gilmore once remarked that the UCC, as a code, goes as far as it goes and no farther. Section 1-103, entitled "supplementary general principles of law applicable," gives directions on where to go when other state or federal law is not "displaced by the particular provisions of this Act."*

*There are two specific questions: (1) Does the UCC displace the common law in a particular area: and, if not, (2) What common law principle*

---

<sup>47</sup> See generally RICE, *supra* note 43.

1. The provision is § 2-208. Another candidate for transfer is § 2-302.

2. See Ritter & Boss, *The Commercial Use of Electronic Data Interchange—A Report and Model Trading Partner Agreement* (1990)(available from the American Bar Association).

should the court choose? A broader interpretive question is whether § 1-103 provides sufficient flexibility and guidance for the courts to develop principles within the framework of the UCC, without having to find and integrate other "principles of law and equity."

For example, Article 2 uses but does not define the term "offer." See § 2-206(1) & 2-207(1). Arguably, under § 1-103 these sections do not displace the common law definition.<sup>3</sup> Is a court bound by whatever concept of offer is applicable in the state or may the court develop a definition which is consistent with the formation policies found in Article 2, Part 2? This is an important question for which there is no clear answer. Since the general law of contract has developed in an uneven fashion and the precedent in a particular state may have been announced without reference to either Article 2 or the Restatement, Second, of Contracts, some further guidance to the court is needed.<sup>4</sup>

**Rec. Art.1 (1).**

The Study Group recommends that the Drafting Committee consider how § 1-103 might be revised to expand the displacement of common law contract principles that are inconsistent with the policies of Article 1 and Article 2, if not their specific provisions. With expanded displacement, the Drafting Committee should also consider how to give a court guidance in fashioning principles within the framework of the UCC. For example, the Comments could state a preference for the Restatement, Second as a reliable source of modern contract law and encourage courts to reject external precedents not clearly displaced by a particular section which are, nevertheless, inconsistent with dominant Code policies.<sup>5</sup>

[TASK FORCE - 1-103]

ARTICLE 1—PART 1

SECTION 1-103

As presently written, U.C.C. section 1-103 is hopelessly indeterminate. Its language tells us very little about the appropriate

---

3. See Hillman, McDonnell & Nickles, *Common Law and Equity Under the UCC* § 2.03 (1985).

4. See also, Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 Nw. U.L. Rev. 906 (1978)(arguing for a broader construction of the displacement principle).

5. These revisions would be consistent with the civil law conception of a commercial code. For an early analysis of this problem, see Comment, *The UCC as a Premise for Judicial Reasoning*, 65 Colum. L. Rev. 880 (1965).

result in a particular case. In all but the uncommon "easy case"<sup>48</sup> courts seem free to open the door to common law and equitable principles to whatever extent they choose. Although there have been several commendable attempts,<sup>49</sup> a meaningful interpretation of the only textual clue to its application (the "[u]nless displaced" language of section 1-103) has not been achieved.<sup>50</sup> It cannot be assumed that courts will or will not import into a Code case a particular non-Code rule.

The Task Force agrees with the Study Group that a serious reconsideration of the extent to which common law and equitable principles continue to serve as sources of law in resolving cases under the Code is necessary. A better appreciation of the importance this issue has to commercial law development should ultimately result in an approach which makes the law more predictable and which better facilitates the essential need to keep the Code responsive to commercial practice. The Task Force, however, questions whether the Study Group has offered a workable solution.

The recommendation that section 1-103 be revised to expand the displacement of contract principles that are inconsistent with Code policy is theoretically appealing but practically unsound. The problem with an analysis emphasizing policy is that the Code is replete with conflicting policies and goals.<sup>51</sup> What then is to prevent their manipulation to reach a desired outcome? Once policy be-

---

48 An example of an easy case is the Code's explicit displacement of the pre-existing duty rule. See U.C.C. § 2-209(1) (1990) ("An agreement modifying a contract within this Article needs no consideration to be binding.").

49 In addition to the sources cited in the Preliminary Report, one should also consult the trilogy of articles written by Professor Nickles. See Nickles, *Problems of Sources of Law Relationships Under the Uniform Commercial Code—Part I: The Methodological Problem and the Civil Law Approach*, 31 ARK. L. REV. 1 (1977); Nickles, *Problems of Sources of Law Relationships Under the Uniform Commercial Code—Part II: The English Approach and a Solution to the Methodological Problem*, 31 ARK. L. REV. 171 (1977); Nickles, *Problems of Sources of Law Relationships Under the Uniform Commercial Code—Part III: Using the Proposed Approach to Resolve the Methodological Problem*, 34 ARK. L. REV. 1 (1980).

50 See generally Frisch, *Buyer's Remedies and Warranty Disclaimers: The Case for Mistake and the Indeterminacy of U.C.C. Section 1-103*, 43 ARK. L. REV. 291 (1990).

51 For example, a crucial premise underlying Article 2 is that the parties are free to establish the terms of their contract. Yet, this freedom is not without restriction. Section 2-302 offers a way of disarming unconscionable bargains, and § 1-203 provides that the parties may not disclaim the prescribed obligation of good faith.

comes the sole arbiter of decision, courts will be free to decide cases on a statutory or common law basis almost without restriction. Therefore, to the extent that a methodology seeks to derive precise answers from imprecise expressions of the drafter's intent, the objectives of certainty, predictability and uniformity of commercial law cannot be achieved. Moreover, what if Code policies conflict? How is a court to decide in favor of one policy or the other?

Perhaps the solution lies not in a revision of section 1-103, but rather in the drafting of the sections themselves. The Drafting Committee could try to make clear in each section—clearer than the original framers—which common law doctrines continue to survive in which contexts. Also, the official comments could suitably serve as a forum for the discussion of the viability of related non-Code law. The point is that the Study Group's recommendation, if implemented, could have the untoward effect of increasing confusion and nonuniform interpretation.

*[PRELIMINARY REPORT - 1-105]*

*C. TERRITORIAL APPLICATION OF THE ACT; PARTIES' POWER TO CHOOSE APPLICABLE LAW: § 1-105.*

*Since § 1-105 was first approved,<sup>6</sup> considerable scholarly attention has been lavished upon choice of law theory in general.<sup>7</sup> Less attention, however, has been paid to § 1-105,<sup>8</sup> presumably because it is easier to accept its statement of general principles of choice of law when the relevant law to be chosen is uniform. Uniformity, however, has been increasingly disrupted by non-uniform versions of Article 2,<sup>9</sup> variant consumer protection legislation and diverse certificate of title acts, to name a few sources of discontent. These trends increase the importance of § 1-105 in sales disputes that sprawl across state lines.<sup>10</sup>*

*Rec. A.1 (2).*

---

6. See the somewhat skeptical analysis of § 1-105 by Professor Paul A Freund in *1 N.Y. Law Rev. Report* 175-189 (1955).

7. Some of the competing theories are discussed in Reese, *A Suggested Approach to Choice of Law*, 14 *Vt. L. Rev.* 1 (1989).

8. There has been little recent discussion of § 1-105. For an early analysis, see Nordstrom, *The UCC and Choice of Law*, 1969 *Duke L.J.* 623.

9. See Revision at 403-04.

10. Under § 1-105(1), the choice standard is so broadly stated that in the typical case a court could always enforce the choice of law agreement of the parties and, if none, always select the law of the forum.

*In light of these emerging differences in sales law, the Study Group recommends that the Drafting Committee consider whether a revision of § 1-105 is required. More particularly, should there be a separate choice of law section for sales? Compare §§ 2A-105 & 2A-106, which provide specific choice of law principles where leased goods are covered by a certificate of title or the lessee is a consumer.*

[TASK FORCE - 1-105]

#### SECTION 1-105

The Task Force has a few concerns regarding section 1-105. First, some members have taken the position that the section should be restricted so that it would not be applicable to a wide range of contracts (usually form contracts) which, while not unconscionable, do not reflect a real choice by one of the parties. In this regard perhaps a provision similar to section 2A-106 would be appropriate.<sup>52</sup>

The second concern about the current language of the present section is that it specifies a list of Code provisions which override the right to contractual choice of law. Other sources of exceptions should also be included. For example, many states have statutes which regulate consumer credit contracts—especially as to interest rates, but also as to some of their terms.<sup>53</sup> These statutes usually specify that they apply, regardless of contractual language to the contrary, to all transactions where the debtor is a citizen of the state enacting the statute.<sup>54</sup> Thus many states now have in effect two statutes which contradict each other: Section 1-105, which says its choice of law provision governs over all statutes except those listed, and the consumer credit statute which, while not listed, plainly states that it governs. The list in section 1-105 is, therefore, too limited and needs some sort of a residuary category.

---

<sup>52</sup> Section 2A-106 states, in pertinent part,

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, the choice is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable.

U.C.C. § 2A-106 (1990).

<sup>53</sup> See, e.g., KAN. STAT. ANN. §§ 16a-1-101 to -6-414 (1988).

<sup>54</sup> Id. § 16a-1-201.

Thirdly, and finally, the Code permits the parties to choose the law of any reasonably related state. Even modern, flexible choice of law doctrines do not go so far. For example, the Restatement (Second) of Conflicts of Laws provides that a contractual choice of law will be valid if: (1) it selects a state reasonably related to the transaction, and (2) the law selected is not violative of the public policy of a more related state.<sup>55</sup> The Drafting Committee is encouraged to consider adding that second restriction. On this point, it has been suggested that the current, more flexible approach means that states have virtually no legislative power because state rules can be circumvented at will unless everything associated with a contract is from one state (a rare event these days).<sup>56</sup> Thus, support for contractual choice of law among Task Force members is not unanimous.

*[PRELIMINARY REPORT - 1-106]*

*D. REMEDIES TO BE LIBERALLY ADMINISTERED:  
§ 1-106.*

*Rec. A.1 (3).*

*Although no revisions are recommended in the text of § 1-106, the Study Group recommends that the policy in § 1-106(1) be stated explicitly and elaborated in Article 2, namely, a revised § 2-701. See Rec. A2.7 (1).<sup>11</sup>*

*[TASK FORCE - 1-106]*

SECTION 1-106

The Task Force believes that Section 1-106, with its mandate for a liberal administration of remedies, is the most important

---

<sup>55</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (rev. 1989).

<sup>56</sup> Under old-style "territorialists" choice of law analysis, the parties could not choose the law applicable to a contract; the validity of a contract was determined by the law of the place the contract was signed (last signature), and issues relating to breach were determined by the law of the place of performance. To permit the parties to choose the applicable law would mean that the parties had the right to veto legislation.

<sup>11</sup> *This recommendation finds support in recent cases which have invoked § 1-106(1) to impose controls upon the choice of remedies given to sellers and buyers in Article 2, Part 7. See White, The Decline of the Contract-Market Damage Model, 11 U. Ark. Little Rock L.J. 1 (1988-89).*

remedy provision in the Code. The case law on Code remedies demonstrates that the courts have made liberal use of this mandate to achieve sensible results even though a different result might have been indicated by a literal construction of a particular remedy provision. In this vein we note that the recommendations of the Study Group regarding Code remedies merely reflect the case law encrustation of the past quarter century. Thus, a strong case can be made for the proposition that the Code's remedy provisions are functioning quite well and do not need extensive revision.

*[PRELIMINARY REPORT - 1-201(9)]*

**E. GENERAL DEFINITIONS: § 1-201(9): BUYER IN THE ORDINARY COURSE OF BUSINESS.**

§ 1-201(9), which has relevance to both Article 2 and Article 9, defines "who" is a buyer in the ordinary course of business (BIOCB) but does not state "when" that status arises. This has caused disagreement in disputes arising under both § 2-403(2) and § 9-307(1). In addition, other questions concerning the prose<sup>12</sup> and the effect of this important definition have arisen. The Study Group concluded that, from the perspective of Article 2, specific revisions in § 1-201(9) should be made.

**Rec. A.1 (4).**

*The Study Group recommends the following revisions in the text of or the comments to § 1-201(9). They are stated here, even though some will be repeated elsewhere in the Report and others will be implemented by revisions in other sections of Article 2 or, possibly, Article 9.<sup>13</sup>*

*(A) The case of Tanbro Fabrics<sup>14</sup> apparently held that a BIOCB of goods from a seller took free of a security interest in the goods even though they were in the possession of the seller's secured party. Unless the secured party has authorized the disposition, we reject*

---

12. See Gopen, *Let the Buyer in Ordinary Course of Business Beware: Suggestions for Revising the Prose of the UCC*, 54 U. Chi. L. Rev. 1178 (1987).

13. A Study Group to review Article 9 has recently been appointed by the ALI and the PEB. Our recommendations will impinge upon that Study Group's jurisdiction and coordination will be required. Nevertheless, we have taken positions that appear to be sound from the perspective of Article 2. See Harrell, *Sales-Related Conflicts Between Articles 2 and 9*, 22 U.C.C. L.J. 134 (1989).

14. *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 39 N.Y.2d 632, 350 N.E.2d 590 (1976).



*the rule of Tanbro Fabrics and recommend an appropriate revision of § 9-307(1) or § 1-201(9).<sup>15</sup>*

*(B) We recommend that the time when the status of BIOCB arises before delivery should be no earlier than the time when the buyer has a right to possession of the goods under Article 2. This revision should be made in § 1-201(9). Exactly when the buyer has a right to possession is determined by §§ 2-711 through 2-716.<sup>16</sup>*

*(C) We recommend that the "objective" definition of good faith for the merchant buyer, see § 2-103(1)(b), be applicable to all disputes where a merchant claims to be a BIOCB. Thus, to qualify as a BIOCB under § 9-307(1) and § 2-403(2), a buyer would have to be honest and to observe reasonable standards of fair dealing to take free of a security interest. This revision should be made in § 1-201(9).<sup>17</sup>*

*(D) Two other revisions in the definition of BIOCB in § 1-201(9) are recommended.*

*The first revision concerns pawnbrokers. Initially, the Drafting Committee should decide whether special rules are required for pawnbrokers and, if so, whether they should be developed outside of § 1-201(9). In any event, the phrase "but does not include a pawnbroker" should be revised to clarify that it refers to a seller, not to a buyer. The current version of § 1-201(9) is ambiguous.*

*Second, the phrase "or leasehold interest" should be inserted after "security interest" in line 3 to conform to § 2A-103(1)(a).*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 1-203]

#### F. OBLIGATION OF GOOD FAITH: § 1-203.

*The obligation of good faith is imposed by § 1-203 on "every contract or duty within this Act. . . in its performance or enforcement. Accord: Restatement, Second, Contracts § 205. The general definition of good faith*

---

15. The Study Group agrees that if a buyer otherwise in the ordinary course of business can recover goods in the possession of its seller's secured party, important commercial expectations may be impaired. See Dolan, *The Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods*, 56 Tex. L. Rev. 1147 (1978).

16. We agree with the conclusions in Frisch, *Buyer Status under the UCC: A Suggested Temporal Definition*, 72 Iowa L. Rev. 531 (1987).

17. See Article 4A-105(a)(6), where good faith "means honesty in fact and the observance of reasonable commercial standards of fair dealing."

is "honesty in fact." § 1-201(19). The special definition for merchants in Article 2 is "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." § 2-103(1)(b). The imprecision of the good faith standard and the tension between the subjective and objective definitions has stimulated a torrent of words in the law journals. The divergent views expressed indicate that any attempt to define more precisely what is good faith or bad faith would be counterproductive.

*Rec. A.1 (5).*

Although the Study Group agrees that good faith should be expressed as a general standard, the following recommendations are made to improve clarity in and to expand the scope of its application.

(A) The scope of the obligation should remain limited to the "performance or enforcement" of the contract for sale. A majority of the Study Group concluded that, unless the parties have otherwise agreed, there was no justification for extending the obligation to pre-contract negotiations which do not result in a contract for sale.<sup>18</sup>

(B) It should be made clearer in the comments or in the text of Article 2, Part 7, that bad faith in "performance or enforcement" is a breach of contract for which contract remedies are available. Unless the conduct amounts independently to a tort, bad faith under § 1-203 is not conduct for which punitive damages are available. See § 1-106(1).

(C) It should be made clearer in the text of § 2-103(1)(b) that the "objective" standard of good faith applies to all issues of performance and enforcement where merchants are involved, not just those sections which specifically mention "good faith."<sup>19</sup>

(D) The Drafting Committee should consider whether the definition of good faith should include a "reasonableness" component for all commercial sellers and buyers, not just merchants. For "merchants" under Article 2, good faith "means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." § 2-103(1)(b) (emphasis added.) For other commercial parties, i.e., those who are not consumers, good faith could mean "honesty in fact and the observance of reasonable commercial standards of fair dealing." See § 4A-105(a)(6). Such a revision should be made in § 2-103(1)(b).

---

18. See generally, Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 Colum. L. Rev. 217 (1987).

19. A literal reading of § 2-103(1) suggests that the phrase "good faith" must actually appear in the text before the "merchant" definition applies. This reading should be rejected.

*The Drafting Committee should also consider whether an "objective" standard of good faith is appropriate for all commercial parties subject to the entire UCC.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 1-205]

**G. COURSE OF DEALING AND USAGE OF TRADE: § 1-205.**

*Section 1-205 is a crucial component of the broad definition of agreement in § 1-201(3). Our impression is that its potential has been under-utilized by the courts.*

*Rec. A.1 (6).*

*The Study Group endorses the objectives of and recommends no major revisions in the text of § 1-205. We do recommend, however, a new subsection for § 1-205 and a new, separate section in Article 1 dealing with Proof of Facts at Trial.*

*(A) The new subsection to § 1-205 is taken from § 2-208, "Course of Performance or Practical Construction," now located in Article 2. "Course of Performance" is part of the definition of Agreement in § 1-201(3). This important principle of interpretation should not be limited to contracts for the sale of goods. Thus, we recommend that § 2-208(1) be moved from Article 2 to § 1-205. In addition, we recommend that § 1-205(4) be revised to incorporate the principles of subordination expressed in § 2-208(2). In sum, § 2-208(1) and (2) should be integrated into subsections of § 1-205.<sup>20</sup>*

*(B) The new section for Article 1 would be taken from an article by Professors Allen and Hillman, entitled "Evidentiary Problems In-And Solutions For-The Uniform Commercial Code"<sup>21</sup> The new section, entitled "Rules Governing the Proof of Facts at Trial," would provide comprehensive guidance to the parties and the courts in the proof of facts. The Study Group recommends that the Drafting Committee give careful consideration to its adoption, along with appropriate definitions, as part of Article 1.*

---

<sup>20</sup> In the process, the principles of subordination should be reviewed to insure that they are not too rule oriented.

<sup>21</sup> 1984 Duke L.J. 92, 98.

## [TASK FORCE - 1-205]

## SECTION 1-205

The role of trade usage was central to Llewellyn's view of Sales law.<sup>57</sup> That role is reflected in Article 2. Courts' timid approach to trade usage has caused a number of sections not to work as well as they should have.<sup>58</sup> The Study Group should consider adopting Llewellyn's proposals to use panels composed of merchants to make non-binding findings on trade usage. Those proposals, together with the discussion of them at the 1942 Annual Conference are appended.<sup>59</sup>

At the time they were initially discussed, these proposals may have seemed radical, and this may be why they were not adopted.<sup>60</sup> Today they are not unusual. In fact, they resemble the procedures for medical malpractice screening panels extant in several states.

Certainly, if the Study Group moves in the direction of recommending a substantial performance test directly or indirectly (by adding the reference to good faith in 2-601),<sup>61</sup> Llewellyn's merchant panel proposals should be considered. These panels are desirable to minimize the uncertainty inherent in the substantial performance test.<sup>62</sup>

## [PRELIMINARY REPORT - 1-206]

*H. STATUTE OF FRAUDS FOR KINDS OF PERSONAL  
PROPERTY NOT OTHERWISE COVERED: § 1-206.*

*§ 1-206(1) provides a separate statute of frauds for the sale of personal property, but "does not apply to contracts for the sale of goods (Section 2-*

---

57 See Selected Comments to Uniform Revised Sales Act, General Comment on Parts II and IV, Formation and Construction 3-4 (1948) in the Llewellyn Papers, file J(LX)(2)(a) (reproduced *infra* App. A).

58 See, e.g., U.C.C. §§ 2-207, 2-615 (1990).

59 See Apps. C & D.

60 The merchant panel proposals first appear in the Draft for a UNIFORM SALES ACT, 1940 § 69 (reproduced in App. B). They are significantly expanded in the Revised Uniform Sales Act, Second Draft §§ 59 to 59-D (Dec. 1941) and were discussed in the National Conference of Commissioners on Uniform State Laws, Fifty-Second Annual Conference, August, 1942. See Apps. C & D (providing the relevant documents and transcript). The proposals disappear from the next draft of the Sales Act (UNIFORM COMMERCIAL CODE - REVISED UNIFORM SALES ACT, Third Draft (1943)) and do not recur, perhaps because the objections raised in The 1942 Annual Conference could not be overcome.

61 Prelim. Rpt., Part 6, Rec. A2.6(1)(A), (B), *infra* p. 1158-59.

62 *Report & Second Draft, The Revised Uniform Sales Act*, Conference of Commissioners on Uniform State Laws (1941) § 11-A (Dec. 1941), *reprinted in* 1 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 381, 383-84 (1984).

201). . . .” § 1-206(2).<sup>22</sup> But if goods are sold in a contract where services predominate, § 2-201(1) does not apply. Does § 1-206(1) still govern if the value of the personal property exceeds \$5,000? The answer is not clear.<sup>23</sup> If § 1-206(1) applies, another problem emerges. There are major differences between the two statutes of frauds: More detail is required in § 1-206 to satisfy the writing requirement than in § 2-201(1) and no statutory exceptions, such as those provided in § 2-201(3), are provided at all.

*Rec. A.1 (7).*

*The Study Group recommends that § 1-206 be revised to (1) state that it is inapplicable to any contract where goods are sold if § 2-201 does not apply and, in any event, to (2) conform with any revisions of § 2-201 dealing with the nature of the required writing and any statutory exceptions. The current differences between the two statutes are, arguably, not clearly justified and have caused confusion in the courts.<sup>24</sup>*

*If § 2-201 is repealed, § 1-206(2) should be modified accordingly.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 1-207]

#### *I. PERFORMANCE OR ACCEPTANCE UNDER RESERVATION OF RIGHTS: § 1-207.*

*At common law, if a debtor tendered a check to a creditor in “full payment” of a disputed obligation and the creditor, with knowledge that it was offered in “full” payment, accepted and cashed the check, the obligation was discharged even though the creditor announced that the check was accepted with a “reservation of rights.” A hotly debated question is whether § 1-207 changed the common law rule by providing that a “party who with explicit reservation of rights. . . assents to performance in a manner demanded*

---

22. For a recent effort to interpret § 1-206 where goods were not involved, see *Horn & Hardhart Co. v. Pillsbury Co.*, 703 F. Supp. 1062 (S.D.N.Y. 1989). See also, Note, *UCC § 1-206: A New Departure in the Statute of Frauds*, 70 *Yale L. J.* 603 (1961).

23. The question is in whether a contract where some goods are sold but services predominate and is not within the scope of § 2-201(1) must be treated as a service contract or a contract for sale of goods for purposes of § 1-206(1).

24. See, e.g., *Dairyland Financial Corp. v. Federal Intermediate Credit Bank of St. Paul*, 852 F.2d 242 (7th Cir. 1988), holding that where § 1-206 governed, the performance exception in § 2-201(3) could be applied.

*or offered by the other party does not thereby prejudice the rights reserved.*<sup>25</sup> Since many of the underlying disputes arise under Article 2 (as well as involve Article 3), the issue is relevant to our study.

*Rec. A.1 (8).*

*The Study Group agrees with the proposed revision of § 3-311, which preserves the common law rule under stated conditions where checks are involved and recommends a new § 1-207(2) to insure that § 1-207 does not apply to an accord and satisfaction.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-101]

**ARTICLE 2, PART 1:  
SHORT TITLE, GENERAL CONSTRUCTION AND  
SUBJECT MATTER**

**A. INTRODUCTION.**

*Part 1 performs a function for Article 2 similar to that performed by Article 1 for the entire UCC. Part 1 deals with the scope of Article 2 and provides a series of important definitions that are applicable throughout the Article. Our approach is to consider in some detail the scope issue and to identify definitions that appear to create the most difficulties.*

**B. SHORT TITLE: § 2-101.**

*No revisions are recommended in the text of § 2-101.*

[TASK FORCE - 2-101]

**ARTICLE 2—PART 1**

**SECTION 2-101**

The Task Force agrees that no change is necessary here. While

---

25. Compare *Horn Waterproofing Corp. v. Bushnick Iron & Steel Co., Inc.*, 66 N.Y.2d 321, 497 N.Y.Supp.2d 310, 488 N.E.2d 56 (1985)(common law rule displaced) with *County Fire Door Corp. v. C. F. Wooding Co.*, 202 Conn. 277, 520 A.2d 1028 (1987)(common law rule not displaced). In check cases, most courts have agreed with the result reached by the Supreme Court of Connecticut. See *Grosse & Goggin, The 1-207 Dilemma Revisited*, 16 N. Ky. L. Rev. 425 (1989).

it is clear that Article 2 covers a broader array of transactions than just sales, however, the title section is qualified and clarified by the subsequent section on scope (2-102), and questions of scope are addressed there.

There is no compelling reason to change this section because, after forty years or so, everyone is used to calling it the "sales code." Since section 2-102 sets out the scope of the Code, no one is likely to be misled by the name. However, because it is widely held that Article 2 covers "transactions in goods" (see discussion on 2-102 below), it would be reasonable to at least consider merging 2-101 and 2-102 or, in some way, reconciling these two sections.

*[PRELIMINARY REPORT - 2-102]*

**C. SCOPE; CERTAIN SECURITY AND OTHER  
TRANSACTIONS EXCLUDED FROM THIS ARTICLE: § 2-102.**

***Rec. A2.1 (1).***

*The Study Group recommends the following revisions in the text of or comments to § 2-102.<sup>1</sup>*

***1. Some Problems.***

*The scope of Article 2 currently is determined from several sources: (1) the text of § 2-102 and § 2-107; (2) the definitions of "goods," "seller," "buyer" and "contract for sale" in Part 1; (3) the language, frequently restrictive, in particular sections of Article 2, e.g., § 2-314(1);<sup>2</sup> (4) the preemptive scope of other Articles of the UCC, e.g., Article 9; (5) the preemptive effect of federal and other state law, and (6) the power of a court to apply Article 2 by analogy in cases to which it does not apply by its terms.<sup>3</sup>*

---

1. The Study Group has benefited from a thoughtful memo on § 2-102, prepared by Professor Ann Lousin of the John Marshall Law School.

2. E.g., § 2-314(1) imposes an implied warranty of merchantability in a "contract for their sale" rather than in a "transaction" in goods. Other sections, such as § 2-201(1), contain similar limitations.

3. See, e.g., *Zapatha v. Dairy Mart, Inc.*, 381 Mass. 284, 408 N.E.2d 1370 (1980)(franchise agreement); *Barco Auto Leasing Corp. v. PSI Cosmetics, Inc.*, 125 Misc.2d 68, 478 N.Y.S.2d 505 (Civ. Ct. City of N.Y. 1984)(lease of goods); *D. Murray, Under the Spreading Analogy of Article 2 of the UCC*, 39 Fordham L. Rev. 447 (1971). Cf. *Comment, Disengaging Sales Law from the Sale Construct: A Proposal to Extend the Scope of Article 2 of the UCC*, 96 Harv. L. Rev. 470 (1982).

*The complexity of the scope problem has been eased by the promulgation of Article 2A: The lease is not a transaction in goods to which Article 2 applies. But what about "pure" service contracts?*<sup>4</sup>

*(A) A majority of the Study Group agrees that Article 2 should not be directly applied to the "pure" service contract. As for extension by analogy, see Rec. A.2.1(1)(F).*

*Between the extremes of the "pure" service contract and the "pure" contract for the sale of goods, lie the so-called "mixed" transactions, where the transfer of goods is combined with personal or professional services in various contexts, including construction contracts. A current example of some interest is a contract for the sale or license of computer systems, which involves hardware, software and various backup services.<sup>5</sup> Are these "transactions in goods" to which Article 2 should apply? Is scope an either-or proposition, or is there room for a selective application of relevant Article 2 sections to a part of the transaction?*<sup>6</sup>

*Here are some possible approaches to these persistent scope problems.*

## *2. Possible Solutions:*

### *Influence of Context.*

*The scope principles of § 2-102 are limited by the phrase, "unless the context otherwise requires. . . ." No one is sure what this means, and the courts have not provided much enlightenment. It confuses an already complex problem.*

*(B) The Study Group recommends that this phrase be clarified in either the text or the comments.<sup>7</sup>*

### *Relationship to Article 9.*

*Section 2-102 does not apply to "any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction." Section 9-102(1)(a) provides that Article 9 applies to "any transaction (regardless of its form) which is intended to create a security interest in person property or fixtures. . . ." A typical transaction involves a "sale and repurchase" agreement. The mesh*

4. See, e.g., Note, *The Goods/Services Dichotomy and the UCC: Unweaving the Tangled Web*, 59 *Notre Dame L. Rev.* 717 (1984).

5. See, e.g., Rodau, *Computer Software Contracts: A Review of the Caselaw*, 21 *Akron L. Rev.* 45 (1987). A Study Committee, under the auspices of the National Conference of Commissioners on Uniform State Laws, is considering whether a Uniform Computer Software Contracting Act should be prepared.

6. See Revision at 402-03 (suggesting that the traditional scope of Article 2 should be "reconsidered in light of the changing practices and needs of the parties involved").

7. Professor Lousin would delete the phrase because it is "ambiguous and, in fact, appears to restrict the scope of Article 2." Lousin, *Memo to Study Group 3*.



here is uncertain and may unduly restrict the application of Article 2 in transactions where both Article 2 and Article 9 should apply.

**(C) The Drafting Committee should identify such cases and provide some guidance for disposition in the comments.**

*Relationship to Other State and Federal Statutes.*

Section 2-102 also provides that "nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers." This phrase is inartfully drafted and provides no indication of what those statutes are.

**(D) The Study Group recommends, at the very least, that a list of either particular statutes or types of statutes be provided in the text of § 2-102. Section 2A-104, which lists "types" of statutes to which a lease governed by Article 2A may be subject, provides a possible model for revising the current language of § 2-102.**

*"Transactions in Goods."*

The Study Group agreed that we could "live with" the phrase "transactions in goods" in § 2-102, as interpreted in "mixed" transactions by the courts, as well as with occasional judicial decisions extending Article 2 by analogy. The lack of precision here, however, produced some extended discussion of possible alternatives.

One possibility is to revise § 2-102 to apply to "contracts for the sale of goods" (a restriction) but indicate in the comments that the phrase includes contracts where the sale of goods is a predominate part. Some guidance might then be given on when goods "predominate" in the transaction.

Another possibility is to revise § 2-102 to apply to any transaction where goods are sold (an expansion) unless the sale is incidental.<sup>8</sup>

The middle ground between the extremes in the mixed transaction is to identify the area of dispute, i.e., warranties, and, if it involves goods, apply Article 2 to that dispute and non-code law to the balance.

**(E) Without taking a position, the Study Group recommends that the Drafting Committee review the various options and either preserve the current language of § 2-102 or select an alternative approach, such as those identified above.<sup>9</sup>**

---

8. Professor Lousin suggested the following language: "This Article applies to sales of goods, to transactions that are substantially similar to sales and to sales of goods and other things or services where the transfer of the goods from one party to another is a substantial component of the sale." Lousin, Memo to Study Group 1.

9. Some of the Study Group favors the approach taken in § 2.2 of a proposed revision of the Canadian Sale of Goods Act. (The proposal was made in 1982 but was

*Extension by Analogy.*

Neither Article 1 nor Article 2 contains a section defining when, if ever, a court should extend Article 2 by analogy to disputes not otherwise within its scope. The pressure for this extension is greatest where the dispute involves the quality of goods transferred in a transaction where services predominate.<sup>10</sup> The need for a section on extension, however, will vary with which scope option is selected for § 2-102. For example, if the "middle ground" option were selected, there would be no need for an extension section (disputes involving goods would always be covered) unless the court exercises its discretion to extend Article 2 to "pure" service disputes or other transactions in goods, such as a bailment or loan of goods.<sup>11</sup>

(F) The Study Group recommends that some explicit provision governing extension by analogy be included in Article 2 or in a comment and that the provision be tailored to the "scope" option selected for inclusion in § 2-102. See § 2A-102, Comment.

*Consumer Protection.*

The Drafting Committee's recommendations on the extent to which Article 2 should provide special protection for consumer sellers and buyers are outlined in Rec. Int.(2).

(G) For purposes of the initial scope determination, we recommend that language similar to that in § 9-206(1) and § 2A-104, be inserted in a new subsection to § 2-102.

[TASK FORCE - 2-102]

## SECTION 2-102

The problem with this section is that the scope of Article 2 is unclear. Although the title appears to limit it to "sales," the text begins with the phrase "Unless the context otherwise requires, this Article applies to transactions in goods . . . ." The Report

---

never enacted).

§ 2-2. — (1) This Act applies to every contract of sale of goods.

(2) Whether or not a contract in the form of a lease of goods, bailment, hire-purchase, consignment or otherwise is a contract of sale depends on the intention of the parties, the substantial effect of the contract and all the other surrounding circumstances.

(3) Any of the provision of this Act, if relevant in principle and appropriate in the circumstances, may be applied by analogy to a transaction respecting goods other than a contract of sale such as a lease of goods or a contract for the supply of labour and materials.

10. Implied warranties of quality are rarely found in service contracts. But see *Broyles v. Brown Engineering Co.*, 275 Ala. 35, 150 So.2d 767 (1963).

11. Conversely, if the first possibility were adopted (scope restricted), a greater need for guidance on extension by analogy would exist.

points out that no one is sure what the phrase means, and there is some suggestion in the Report that the phrase should be deleted.

This mysterious language was added to the Code in a 1956 revision,<sup>63</sup> which was a response to the Report of the New York Law Revision Committee<sup>64</sup> which had criticized the Code for not having a scope section. This language both broadened and narrowed the scope of Article 2. It narrowed it by limiting it to goods,<sup>65</sup> but it broadened it by expanding its application to "transactions,"<sup>66</sup> which covers a broader array of relationships than simply sales.

Because of the range of possible relationships which could be covered by the term "transactions," the drafters concomitantly added the precatory limiting language "[u]nless the context otherwise requires . . . ." This language was supposed to limit the application of Article 2 in certain transactions other than sales. How this was to be limited is unclear, however. One commentator has suggested that the language meant that:

it was widely assumed in commercial circles that this qualification would prevent the application of any section in Article 2 to a case not involving a sale if the section to be applied used sales language, such as "sale," "buyer," or "seller." Thus it was expected, for example, that the warranties expressed in sections 2-313, 2-314, or 2-315 would not be applied to a transaction in which goods were leased, because all of these sections employ "sales language," indicating that they are "sales provisions" in-

---

63 18 THE AMERICAN LAW INSTITUTE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM SALES LAW, 1956 Recommendations of the Editorial Board for the Uniform Commercial Code (1956).

64 1 STATE OF NEW YORK REVISION COMMISSION REP.: STUDY OF THE U.C.C. (Hein & Co.) (1955).

65 "Goods" is a term which is defined in the Code in § 2-105(1):  
(1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2-107).

66 U.C.C. § 2-105 (1990). The Code does not define the term "transaction." See generally U.C.C. § 1-201 (1990).

appropriate for non-sales cases. In other words, it was thought that the context of these sections, and others like them, militated against their use in non-sales cases.<sup>67</sup>

This view, though, has not been generally recognized by the courts. Several courts have taken the position that Article 2 is applicable to non-sales transactions in goods even if the applicable section is specifically addressed to a sales situation, if the policies underlying the section are reasonably applicable to the non-sales situation under consideration.<sup>68</sup>

It is therefore clear, as the Study Group points out, that this language creates some difficulty and that it is in need of clarification. We find the suggestion that the language be deleted altogether as an inappropriate response. Article 2 is primarily geared toward sales transactions, and the fact that it is inappropriate for certain other types of contractual relationships should be specified.

The language "transactions in goods" has been especially troublesome in regard to "mixed" transactions. The Study Group does not recommend anything in particular, but suggests several possibilities to deal with this confusion. One suggested possibility is to change the language to "contracts for the sale of goods," which would be a restriction of the present language, but clarify this in the comments to note that it covers any transaction which is predominantly a sale of goods. Another suggested possibility is to revise section 2-102 to apply to any transaction where goods are sold, unless the sale of goods is incidental, which would be an expansion of the present language.

It is not clear how either proposed revision would clarify the borderline between covered transactions and those outside Article 2. This ambiguity may explain why the Study Group did not advocate a particular position. Perhaps it is advisable to leave well enough alone and let the courts continue as they have been doing.

The Study Group recommends the addition of a provision explaining the appropriate times that Article 2 should be extended

---

67 1 W. HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* (Callaghan) § 2-102:03 (1984) (footnote omitted).

68 *See, e.g.,* *W.E. Johnson Equip. Co. v. United Airlines, Inc.*, 238 So. 2d 98 (Fla. 1970) (holding that a consumer who leases has protection equivalent to a consumer who purchases).

by analogy. This is based on an attempt to update the scope provision of Article 2 to mirror the scope provision of Article 2A: i.e., section 2A-102. To the degree that uniformity between Article 2 and Article 2A is sought, this may be a sound recommendation. However, as a matter of necessity, its usefulness is unclear. Article 2 specifically deals with transactions in goods. It is unclear why it should enumerate those areas outside its own defined scope. The degree to which a court can and should appropriate Article 2 for non-sale transactions is not a statutory, but rather a judicial function.

Section 2-102 declares that Article 2 "does not apply to any transaction which . . . is intended to operate only as a security transaction." Since some transactions might properly come within both Article 2 and Article 9, the Study Group recommends that these types of cases be identified and that the comments provide further guidance. The Code is fairly explicit: transactions solely intended as Article 9 transactions are excluded. Those transactions, which have elements both of a sale (or other non-security type transaction properly covered under Article 2) and a secured transaction, are properly covered by Article 2 (as well as Article 9). This is an area which probably requires flexibility, and an attempt to give a laundry list of potential situations may be misleading and will surely be less than complete.

Finally, in an attempt to get Article 2 to conform to the language of Article 2A, the Task Force further recommends that the language in section 2-102 ("nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers") be changed to "Section 2-102 is also subject to any applicable consumer protection statute of this State." To the degree that is a desirable goal, this recommendation is sound. It is not clear, however, that it would accomplish anything of substance.

*[PRELIMINARY REPORT - 2-103]*

*D. DEFINITIONS AND INDEX OF DEFINITIONS: § 2-103.*

*Rec. A2.1 (2).*

*The following revisions are recommended in the text of § 2-103.*

*A. As recommended in C, above, the Drafting Committee should consider how the phrase "unless the context otherwise requires" can*

*be clarified. Does it operate solely as a restriction on the text and, if so, under what circumstances?*

*B. As recommended in Rec. A.1(5), the Drafting Committee should consider whether all non-consumer sellers and buyers, whether merchants or not, should be held to an "objective" standard of good faith. The language in § 4A-104(a)(6) provides a possible "objective" standard for the commercial buyer or seller who is not a merchant.*

*C. Section 2-103(3) incorporates a definition of "consumer goods" from Article 9: Goods are "'consumer goods' if they are used or bought for use primarily for personal, family or household purposes." § 9-109(1) (Emphasis added). The Magnuson-Moss Warranty Act, however, defines a "consumer product" as "any tangible personal property. . . which is normally used for personal, family, or household purposes. . . ." 15 U.S.C. § 2301(1) (Emphasis added). The Drafting Committee should consider whether the broader definition of consumer goods in the Magnuson-Moss Warranty Act is appropriate for Article 2.*

[TASK FORCE - 2-103]

## SECTION 2-103

Should all non-consumer sellers and buyers be held to an "objective" standard of good faith whether they are merchants or not?<sup>69</sup> The Study Group does not give any reason for considering this proposed change. It does appear to be a sound suggestion, though, because it would set an easier standard for Article 2 contracts which would be much easier to apply by courts. It would also be consistent with the general theory of objective contract interpretation.

Article 2 adopts the Article 9 definition of "consumer goods":<sup>70</sup>

---

<sup>69</sup> Article 1 sets out the general rule of good faith, which applies to all contracts: "'Good faith' means honesty in fact in the conduct or transaction concerned." U.C.C. § 1-201(19) (1990). This has generally been interpreted as a subjective standard, and it is applicable to any transaction within the Uniform Commercial Code. Article 2 sets out a special rule for merchants which incorporates the subjective standard of Article 1 with an objective standard: "'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103(1)(b) (1990).

<sup>70</sup> U.C.C. § 2-103(2) (1990) adopts U.C.C. § 9-109(1) (1990) (definition of consumer goods).

"Goods are . . . 'consumer goods' if they are used or bought for use primarily for personal, family or household purposes . . . ." <sup>71</sup> The Report suggests that the broader definition contained in the Magnuson-Moss Act should replace this definition. The Magnuson-Moss Act defines a "consumer product" as "any tangible personal property . . . which is normally used for personal, family, or household purposes . . . ." <sup>72</sup>

The Article 2/Article 9 definition of "consumer goods" has always caused a problem for retail dealers because it is based on the intentions of the buyer, which are often unknown to the seller. The Magnuson-Moss definition would add certainty in transactions by creating an objective standard to determine whether goods are consumer goods. It would also eliminate from the fact finding process the need to determine the subjective state of mind of one of the parties, thereby adding to the administrative ease of determining Article 2 cases.

*[PRELIMINARY REPORT - 2-104]*

*E. DEFINITIONS: "MERCHANT"; "BETWEEN MERCHANTS"; "FINANCING AGENCY": § 2-104.*

*Rec. A2.1 (3)*

*No revisions are recommended in the text of § 2-104. Comment 1, however, should be revised to clarify that not all commercial buyers are "merchants."*

*[TASK FORCE - 2-104]*

**SECTION 2-104**

The Study Group suggests that Comment 1 be revised to clarify that not all commercial buyers are merchants. Comment 1 implies a broader definition of merchant than is indicated in Comment 2, which assumes some professional, specialized knowledge. The Task Force agrees that there is a large group of buyers who should not be subject to the higher standards imposed on knowl-

---

<sup>71</sup> U.C.C. § 9-109(1) (1990).

<sup>72</sup> 15 U.S.C. § 2301(1) (1990).

edgeable merchants. To the extent that a clarification of Comment 1 would avoid confusion on this point, the recommendation is commendable.

[PRELIMINARY REPORT - 2-105]

F. DEFINITIONS: TRANSFERABILITY; "GOODS";  
"FUTURE" GOODS; "LOT"; "COMMERCIAL UNIT";  
§ 2-105.

*No revisions are recommended in the text of § 2-105.*

[TASK FORCE - NONE]

[PRELIMINARY 2-106]

G. DEFINITIONS: "CONTRACT"; "AGREEMENT";  
"CONTRACT FOR SALE"; "SALE"; "PRESENT SALE";  
"CONFORMING" TO CONTRACT; "TERMINATION";  
"CANCELLATION." § 2-106."

*Rec. A2.1 (4).*

*With one minor exception, no revisions are recommended in the text of § 2-106. Consideration should be given, however, to moving the substantive effect of subsections (3) and (4) out of the definitions. See §§ 2-103 & 2A-505.*

*Greater clarity would be achieved if the last phrase in the first sentence of § 2-106(1) were revised to read "'Contract for sale' includes both a present sale of goods and a contract to sell goods, including future goods, at a future time." Article 2 should clearly apply to the wholly executory contract for the future sale of goods that have not yet been procured, manufactured or planted.*

[TASK FORCE - 2-106]

SECTION 2-106

Because section 2-106 is a "definition" section, the Study Group suggests that subsections 3 and 4 of this section, which state the legal effect of a termination or cancellation, should appropriately be placed in another section.<sup>73</sup> This change, although without substantive effect, would simply restructure the Code in a more orderly fashion and is supported by the Task Force.

---

<sup>73</sup> Subsections three and four of U.C.C. § 2-106 should probably be placed in Part 3 of Article 2 ("General Obligation and Construction of Contract").



Section 2-106(1) presently reads, "In this Article . . . 'contract' and 'agreement' are limited to those relating to the present or future sale of goods."<sup>74</sup> This creates an ambiguity: is this limited to a present contract for future goods, or does it also include the possibility of an agreement for a future contract for the sale of goods. The proposed revision would clarify this confusion by pointing out that it only includes the former.

[PRELIMINARY REPORT - 2-107]

H. GOODS TO BE SEVERED FROM REALTY: RECORDING:  
§ 2-107.

*No revisions are recommended in the text of § 2-107.*

*During the various energy crises over the last 15 years, disputes under long-term contracts between the producers of oil, gas, coal and electricity and purchasers (usually pipelines or utilities) frequently have arisen. The issues involve, inter alia, excuse and adjustment, breach and adequate assurance and remedies. These disputes reveal the wide variety of risk allocation devices employed in energy contracts, including the notorious "take or pay" clause. The disputes frequently involve regulated utilities or arise in transactions somewhere between direct federal regulation of the producers and state regulation of retail sales of energy to consumers.*

*The courts have held that gas, coal and electricity are goods, as long as they are to be "severed by the seller", § 2-107(1),<sup>12</sup> and that the process of severing is complete when the gas or oil enters the purchaser's pipeline. As a result, the courts have been required to apply Article 2 to unique transaction types which are influenced, indirectly, by regulatory rather than market policies.<sup>13</sup> Moreover, the relational implications of the long-term contract frequently collide with those parts of Article 2 with roots in neo-classical concepts of contract. This tension is apparent in the decisions involving the "take or pay" clause.<sup>14</sup> These developments do not warrant an exclusion of energy contracts from Article 2. Quite the contrary, they require a recognition that there are important sub-contexts within contracts*

---

74 U.C.C. § 2-106(1) (1990).

12. E.g., *Manchester Pipeline Corp. v. Peoples Natural Gas Co.*, 862 F.2d 1439 (10th Cir. 1989)(natural gas).

13. See, e.g., Smith, *How the UCC Applies to Natural Resources Transactions*, 33 *Rocky Mtn. Min. L. Inst.* 5 (1987); Note, *Deregulation and Natural Gas Purchase Contracts—Neoclassical and Relational Contract Theories*, 25 *Washburn L. Rev.* 43 (1986).

14. For the view of a producer's attorney, see Medina, *The Take-or Pay Wars: A Further Status Report*, 41 *Okl. L. Rev.* 381 (1988).

*for the sale of goods and that differences within each sub-context pose continuing challenges in the application of Article 2 standards. Before revisions are required, it must first clearly appear that the courts, using sound Code methodology, are unable to protect the interests of both parties within the existing structure and policies of Article 2. To date, at least, the case for a major revision has not been made.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-201]

**ARTICLE 2, PART 2:  
FORM, FORMATION AND READJUSTMENT OF  
CONTRACT.**

**A. OVERVIEW.**

*Without purporting to exhaust the subject matter, Article 2, Part 2 contains 10 sections dealing with the form,<sup>1</sup> formation and adjustment of the contract for sale. In some respects, they marked, in 1958, a sharp departure from the common law.<sup>2</sup> With time, however, the departures have become more familiar, if not less controversial, and many are now reflected in the Restatement, Second, of Contracts. In essence, these sections reduce the requirements of formality and, through the use of standards rather than rules, increase the chance that a contract will be formed earlier rather than later in the relationship. The test is whether the parties intended to conclude a bargain. If so, there is a contract to the extent that "there is a reasonably certain basis for giving an appropriate remedy."<sup>3</sup>*

**B. STATUTE OF FRAUDS: § 2-201.**

*Section 2-201 has generated considerable litigation, controversy and commentary.<sup>4</sup> Despite its ancient lineage, there is no persuasive evidence either that the statute of frauds has prevented fraud in the proof of the making*

---

1. See Hohlahan, *Contract Formalities and the UCC*, 3 Vill. L. Rev. 1 (1957).

2. See Comment, *The UCC and Contract Law: Some Selected Problems*, 105 U. Pa. L. Rev. 836 (1957).

3. Cf. Restatement, Second, Contracts § 33(2), which states that the "terms of a contract are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy."

4. See Revision at 460-63.

of a contract or that its presence has channeled behavior toward more reliable forms of record keeping.<sup>5</sup> On the other hand, there are claims that the statute of frauds is anachronistic,<sup>6</sup> that the treatment of the quantity term corrupts other substantive provisions of Article 2<sup>7</sup> and that the exceptions in § 2-201(3), including the judicially grafted reliance exception,<sup>8</sup> virtually eat up the rule.

On the other side of the Atlantic, England repealed the statute of frauds for sales in 1953.<sup>9</sup> Since then there has been little discussion and no reports about the impact, if any. In short, the statute on frauds has apparently sunk in England without an adverse trace. Furthermore, Article 11 of the United Nations Convention of Contracts for the International Sale of Goods (CISG) provides: "A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirements as to form. It may be proved by any means, including witnesses."<sup>10</sup>

Are these the trends of the future? What would happen in the United States if § 2-201 were repealed? What is the potential impact upon the need for a writing, broadly defined, from the development of sophisticated electronic messaging systems? These are the somewhat cosmic questions that surround § 2-201.

---

5. Professor Vold argued that the "cases that justify the statute are. . . the thousands of uncontested current transaction where misunderstanding and controversy are avoided by the presence of a writing which the statute at least indirectly aided to procure. . . ." Vold, *The Application of the Statute of Frauds Under the Uniform Sales Act*, 15 Minn. L. Rev. 391, 393-94 (1931). An empirical study suggested, however, that reliance on an order rather than the use of a writing was the prevalent practice in some trades. Comment, *The Statute of Frauds and the Business Community: A Re-Appraisal in Light of Prevailing Practices*, 66 Yale L.J. 1038 (1957). There is no recent study testing any of these propositions.

6. See Willis, *The Statute of Frauds-A Legal Anachronism*, 3 Ind. L.J. 427 (1928).

7. Bruckel, *The Weed and the Web: § 2-201's Corruption of the UCC Substantive Provisions—the Quantity Problem*, 1983 U. Ill. L. Rev. 811 (1983).

8. See, e.g., Metzger & Phillips, *Promissory Estoppel and § 2-201 of the UCC*, 26 Vill. L. Rev. 63 (1980); Restatement, Second, Contracts § 139.

9. See Grunfield, *Law Reform (Enforcement of Contracts) Act, 1954*, 17 Mod. L. Rev. 451 (1954).

10. A Contracting State may protect its domestic statute of frauds by making a reservation under Article 96. (The United States has not made a reservation.) In addition, the parties may impose or agree upon formal writing requirements. Thus, an offeror may require that an acceptance be in writing, Articles 18 & 19, and both parties may agree in a written contract that "any modification or termination by agreement" be in writing. Article 29. See § 2-209(2).

### 1. Repeal the Statute of Frauds?

#### **Rec. A2.2 (1).**

*The Committee strongly recommends that the Drafting Committee carefully consider whether to repeal the statute of frauds.*

*Despite the trends noted above, the Study Group was not unanimous that § 2-201 should be repealed. Doubts were created by lack of information (e.g., what the impact would be?) and concerns that the repeal would clash with an evolving Article 2A<sup>11</sup> and developments in the law of lender liability. Furthermore, some were concerned that the need in electronic contracting for an authentication system responded more to concerns about perjury than the objective of providing credible evidence that a contract was formed.*

*In any event, the lack of evidence that the statute of frauds either deters perjury or channels commercial behavior into good habits of form and the specter of courts straining to avoid the statute when it is clear that some agreement existed persuaded most of the Study Group that § 2-201 should go.*

### 2. Amendment of the Statute of Frauds.

#### **Rec. A2.2 (2).**

*Assuming that § 2-201 is not repealed, the Study Group recommends that the Drafting Committee consider the following proposals for clarification or revision.*

##### **(A) Delete all references to quantity now contained in § 2-201.**

*Even if there is a sufficient writing under § 2-201(1), the contract is not enforceable beyond the quantity of goods "shown in such writing," § 2-201(1), or "admitted," § 2-201(3)(b), or "goods. . . which have been received and accepted." § 2-201(3)(c). The purpose is to prevent fraud in the making of the quantity term—a term that cannot be readily supplied as a "gap" filler under Article 2, Part 3. The effect of this requirement has been to induce the courts to strain to find some quantity term to interpret<sup>12</sup> and, in addition, to undercut the basic "gap filling" policies of Article 2,*

---

11. Although §2A-201 exhibits no retreat from the requirements of § 2-201, the expectation of a writing may be more common in leasing practice than in contracts for sale.

12. A leading case is *Riegel Fiber Corp. v. Anderson Gin Co.*, 512 F.2d 784 (5th Cir. 1975), where the court, upon finding a quantity term in the writing, rejected the statute of frauds defense and turned to the question whether the quantity term was "too indefinite to support judicial enforcement."

Part 3 without any evidence that fraud has been deterred or that the fact finding process was impaired.<sup>13</sup>

The effect of any such deletion is simple. If it is clear from the signed writing that some contract for sale has been made, the statute of frauds is satisfied and all of the alleged terms, written or oral, may be proved in the usual way under Article 2.

**(B) Clarify who is a merchant under § 2-201(2).**

The phrase "between merchants" in § 2-201(2) has been interpreted narrowly by some courts, particularly where farmers are involved.<sup>14</sup> This means that a farmer who failed to respond to a confirmation could still assert the statute of frauds defense even though he was a "merchant with respect to goods of that kind."

Clarification of this phrase is required, with emphasis upon whether the narrower definition of merchant, used in § 2-314(1), should also be employed in § 2-201(2), rather than the broader definition in § 2-104(1).<sup>15</sup>

**(C) Clarify in the statute whether reliance on a promise made in an oral agreement within the statute of frauds may be sufficient to make the promise enforceable.**

The cases disagree on the effect of reliance. Clarification is required whether reliance is a proper way to avoid § 2-201(1) and, if so, what limitations should be imposed. Compare Restatement, Second, Contracts § 139 (2), which lists a number of significant factors, including the "extent to which the action or forbearance corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence."

On the merits, the trend is toward a greater use of reliance as an independent ground to enforce an oral promise within the statute of frauds.<sup>16</sup> If this trend is sound, a provision endorsing a reliance alternative should be included in § 2-201.

---

13. For a persuasive attack on the "quantity" requirement, see Bruckel, *The Weed and the Web: § 2-201's Corruption of the UCC Substantive Provisions—The Quantity Problem*, 1983 U. Ill. L. Rev. 811 (1983).

14. See, e.g., *Loeb & Company, Inc. v. Schreiner*, 294 Ala. 722, 321 So.2d 199 (1975).

15. See, generally, Onofry, *The Merchants Exception to the UCC's Statute of Frauds*, 32 Vill. L. Rev. 133 (1987). Much of this definitional nit picking could be avoided if a provision, such as the 1949 version of § 1-102(3), were restored. That subsection provided: "A provision of this Act which is stated to be applicable 'between merchants' or otherwise to be of limited application need not be so limited when the circumstances and the underlying reasons justify extending its application."

16. See, e.g., *R.S. Bennett & Co. v. Economy Mechanical Industries, Inc.*, 606 F.2d 182 (7th Cir. 1979).

*If this trend is rejected, the exclusivity of the statutory exceptions in § 2-201(3) should be stated more clearly in the statute.*

**(D) Clarify in which settings and by what methods after a law suit is filed an "admission" under § 2-201(3)(b) is effective to admit the existence of the contract.**

*One question is whether an admission in pre-trial discovery other than "in his pleading, testimony or otherwise in court" is effective to remove the case from the statute. There is disagreement over this, and the statute, read literally, supports a narrow view. A broader revision might include any authorized pre-trial discovery proceedings where an admission could be introduced as evidence in court.<sup>17</sup> Similarly, the comments might clarify who is a "party" under § 2-201(3)(b). For example, is a former employee who was then acting as agent for the defendant a "party" who can admit the existence of a contract?*

*The Study Group has recommended that all references to "quantity" be deleted from § 2-201. If this revision is adopted, it would, as a practical matter, further broaden the potential scope of § 2-201(3)(b). A party could not escape perjury by admitting the contract but, conveniently, forgetting the quantity term.*

**(E) Clarify that the parol evidence rule does not apply, without more, to a writing used to satisfy the statute of frauds.**

*The usual principle is that even though a writing satisfies the statute of frauds, the "burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected." § 2-201, Comment 3. Decisions holding that an unanswered memorandum which satisfies the statute under § 2-201(2) cannot be contradicted under the parol evidence rule, therefore, should be viewed with suspicion. The parol evidence rule does not exclude evidence relevant to whether an enforceable contract was formed and, in any event, would not apply unless the parties "intended" the memo to be a "final expression of their agreement with respect to such terms as are included therein. . . ." § 2-202.*

**(F) Conform § 1-206 to any revisions made in § 2-201. See Rec. A.1(7).**

**(G) Coordinate any revisions in § 2-201 to developments in electronic data interchange (EDI) and electronic messaging systems (EMS).**

---

17. For such a broad view expressed in a land dispute, see *Anchorage-Hynning & Co. v. Moringiello*, 697 F.2d 356 (D.C. Cir. 1983)(failure to respond to request for admissions waived statute of frauds defense). See also, *Weiskopf, In-Court Admissions of Sales Contracts and the Statute of Frauds*, 19 U.C.C. L.J. 195 (1987).

*Leary and Frisch have stated that in "today's electronic age, the whole concept of a signed writing may need rethinking."<sup>18</sup> Assuming that a system or device to authenticate electronic contracting between trading partners will be developed, the questions of what that system should be and whether a separate Code section and new definitions will be required must be answered.<sup>19</sup> These technological developments in the method and timing of communication arise out of developments not envisioned by the drafters of Article 2 and test the capacity of the Code to keep pace with business developments. In short, § 2-201 can be neither repealed nor revised without considering the effect, no matter how remote, of electronic messaging or electronic data interchange.*

[TASK FORCE - 2-201]

## ARTICLE 2—PART 2

### SECTION 2-201

The original purpose of the Statute of Frauds (now codified at 2-201) was to prevent fraud caused by perjury so that parties would not be held to contracts that they never made.<sup>75</sup> Today, however, the law of agreement, consideration, conditions and illegality have developed in ways that may (not all Task Force members agree) make this less likely.<sup>76</sup> Conversely, it appears that the statute may promote more fraud than it prevents. For example, although the statute requires a writing sufficient to indicate that an agreement was made, the problem of forgery is persistent.<sup>77</sup> In addition, the statute creates a bar to the enforcement of many oral contracts which the parties clearly intended to enter.<sup>78</sup>

On the other hand, the Statute is firmly entrenched in American law both in the Code and in statutes outside the U.C.C.

---

18. See Revision at 462.

19. One proposed solution is to permit the parties to agree in advance of the particular sale on the form of and the documents in the transaction. See American Bar Association, *Model Form of Electronic Data Interchange Trading Partner Agreement and Commentary* § 1.1 (1989).

75 Willis, *The Statute of Frauds—A Legal Anachronism*, 3 IND. L.J. 427, 427 (1928).

76 Id. at 431.

77 See, e.g., Comment, *The Merchant's Exception to the Uniform Commercial Code's Statute of Frauds*, 32 VILL. L. REV. 133, 139 n.24 (1987) (citing J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE U.C.C.* 73 (2d ed. 1980)).

78 Id.

There is, therefore, some concern that inviting states to repeal section 2-201 invites non-uniformity among the states of the worst kind—the requisites of basic enforceability of a promise.

As a consequence of these conflicting policies, the Task Force was unable to reach a conclusion as to whether repeal of the statute would be appropriate. One suggested substitution for the statute would be to alter the burden of proof to require proof by clear and convincing evidence (rather than by a preponderance) of the existence and terms of an oral contract. It is believed by some that the present burden of proof is basically meaningless as a safeguard against error.

*The following discussion is based on the assumption that the Statute of Frauds is not repealed.*

The Task Force is also divided as to whether all references to “quantity” now contained in section 2-201 should be deleted. Some members believe that the quantity provision may nullify substantive provisions of the Code.<sup>79</sup> There is the risk that legitimate contracts for which other sections of the Code promise substantive enforceability will fail, not because of perjury, but on technical issues due to mechanical construction of the contract language.<sup>80</sup> Under these premises, section 2-201 provides a means for avoiding a contract that proves to be a bad bargain.

The problem with the quantity provision conflicting with other substantive law is “most evident in its effect upon ordinary requirements and output contracts.”<sup>81</sup> Under section 2-201(1), if a requirements or output contract omits such “magic” words as “all” or “requirements,” the contract is insufficient under the Statute of Frauds, although no such words are required under section 2-306(1).<sup>82</sup> In some cases involving these contracts, courts have tended to look at the writings in a mechanical way without much consideration of the substance of the agreement.<sup>83</sup>

---

79 See generally Bruckel, *The Weed and the Web: Section 2-201's Corruption of the U.C.C. Substantive Provisions—The Quantity Problem*, 1983 U. ILL. L. REV. 811, 814 (discussing the destructive potential of this section).

80 *Id.* at 815.

81 *Id.* at 817.

82 *Id.* at 819-20.

83 See, e.g., *Cox Caulking & Insulating Co. v. Brockett Distrib. Co.*, 150 Ga. App. 424, 258 S.E.2d 51 (1979) (holding that the phrase in seller's letter “for the above project” was not sufficient as a term of quantity within the statute of frauds, thus barring enforcement of an alleged oral contract).



If the quantity provisions of section 2-201 were eliminated, the quantity terms could be supplied by parol evidence. The burden of proof would still rest with the party asserting the existence of the agreement, so that the likelihood of fraud or misrepresentation would be greatly reduced. Not all members of the Task Force agree with this position. At least one member sees the quantity term as designed to prevent fraud in the making of the most important term in a sales contract, and the only term that cannot be readily supplied by Article 2 gap fillers. Because the price term may be supplied by section 2-305, the quantity requirement places a limit on the size of the contract, thus limiting the size of any fraudulently asserted contract. In addition, any change in section 2-201 would necessitate revision of section 8-319, which also contains a quantity term.

In Comment 2 of section 2-104, three categories of merchants are recognized: (1) a merchant is a person who has knowledge of the particular business practice involved in the transaction,<sup>84</sup> (2) a merchant is a person who has a specialized knowledge in the goods involved in the transaction,<sup>85</sup> and (3) a merchant is a person who has knowledge of either the business practices *or* the goods involved in the transaction (i.e., either of the above two standards).<sup>86</sup>

The Study Group suggests that for the section 2-201(2) exception to the general signature requirement of the Statute of Frauds, the broader definition of merchant (category 3, above) should be employed instead of the more restrictive categories 1 and 2, above. It is not clear to the Task Force, however, that the broader definition should be applicable. If the purpose of the exception is to hold parties who are knowledgeable of the business practices of their industry to bargains they actually made because they should understand the consequences of their acts in a business context, then the exception should apply only to those who have the requisite knowledge.<sup>87</sup> The broader definition of merchant,

---

84 This definition of a merchant is applicable in U.C.C. §§ 2-201(2), 2-205, 2-207, and 2-209.

85 This is applicable in U.C.C. §§ 2-314(1), 2-402(2), and 2-403(2).

86 This standard is applicable for U.C.C. §§ 2-103(1)(b), 2-327(1)(c), 2-603, 2-605, 2-509, and 2-609.

87 See Comment 2 to § 2-104 which states that under §§ 2-201(2), 2-205, 2-207, and 2-209 "almost every person in business" is a merchant under § 2-104(1) "since the practices involved in the transaction are non-specialized business practices such as answering mail." U.C.C. § 2-104 comment 2 (1990).

which incorporates knowledge of the goods as well as of the industry, is irrelevant in achieving this goal. If the purpose of the proposed revision is simply to further erode the Statute of Frauds by expanding the availability of ways to avoid it, then this proposed change will achieve its purpose. As to the question of whether the Code is presently ambiguous about which definition of 'merchant' is applicable for purposes of section 2-201(2), the comments are clear that it is the first definition under section 2-104 ("knowledge or skill peculiar to the practices or goods involved in the transaction") which applies.<sup>88</sup>

The courts are split on the issue of whether reliance avoids the Statute of Frauds. The Study Group suggests that the Code clarify this point one way or the other with the suggestion that, on the merits, it is probably better to allow reliance as an exception to the Statute. Given the sharp division among the states on the issue, the Task Force fears that any amendment is not likely to be uniformly adopted, and may introduce intrastate inconsistency on the issue between the Code and non-Code Statutes of Frauds.

One of the most common arguments against reliance as an exception to the Statute of Frauds is the actual textual language of section 2-201. The section begins with the language: "Except as otherwise provided in this section," which on its face would appear to exclude detrimental reliance, or for that matter, any other exception to the Statute. Yet, courts have continued to allow promissory estoppel as an exception, often relying on section 1-103 of the Code.<sup>89</sup>

The policy of section 1-203 is also supported by the recognition of promissory estoppel principles. This section imposes an obligation of good faith in the performance and enforcement of every contract and duty under the Code.<sup>90</sup> This obligation of good faith may (not all Task Force members agree) encompass the acknowledgement of an oral contract which the other party had relied upon. There is support on the Task Force for the view that the

---

88 U.C.C. § 2-201 comment 2 (1990).

89 To the degree that § 1-103 takes priority over the precatory language of § 2-201, it not only would allow promissory estoppel as an exception to the Statute of Frauds, but would also allow any other judicially created exceptions to apply to the statute's operation. Metzger & Phillips, *Promissory Estoppel and Section 2-201 of the Uniform Commercial Code*, 26 VILL. L. REV. 63, 98 (1981).

90 U.C.C. § 1-203 (1990).

other party *should* (not to say that he *does*) have the right to decline to answer such questions. It has been suggested that one of the important purposes served by evidentiary privileges is the ability to avoid the dilemma of rewarding perjury while punishing the few who are honest.

In support of barring the use of reliance in cases involving section 2-201 is the concern that the application of estoppel principles will result in the practical abrogation of the statute.<sup>91</sup> The argument is that the use of reliance diminishes the evidentiary function of the statute. However, the Code itself recognizes the evidentiary value of reliance in sections 2-201(3)(a), 2-201(3)(c), and 2-209(4).<sup>92</sup> Therefore, it appears that if courts consider the evidentiary value of reliance in promissory estoppel cases the protection afforded by the statute will not be seriously diminished.

The Task Force tentatively recommends an appropriate revision to section 2-201 allowing the promissory estoppel defense to the Statute of Frauds. The language of section 217A(1) of the Restatement (Second) of Contracts provides a possible model:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and does induce action or forbearance is enforceable notwithstanding the Statute of Frauds if injustice can be avoided only by enforcement of the Promise. The remedy for breach is to be limited as justice requires.<sup>93</sup>

The Task Force agrees that there is a need to clarify in which settings and by what methods after a law suit is filed an "admission" under section 2-201(3)(b) will be effective to admit the existence of a contract. The statute reads: "if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court . . . ."<sup>94</sup> This leaves open the question whether an admission in pre-trial discovery is effective to remove the case from the Statute of Frauds. The Study Group recommends that pre-trial admissions be admitted under section 2-201(3)(b).

A majority of the Task Force members concur in this recommendation, although there is some concern that even honest

---

91 Metzger & Phillips, *supra* note 89, at 99.

92 *Id.*

93 RESTATEMENT (SECOND) OF CONTRACTS § 217A(1).

94 U.C.C. § 2-201(3)(b) (1990).

people will be led to perjure themselves because the law effectively requires it. The view that admissions during pre-trial discovery should be admissible comports with the general thrust of this exception, which is to admit into evidence contracts which do not meet the writing requirement of section 2-201(1), but otherwise meet basic standards of proof of their actual existence. If all references to "quantity" in section 2-201 were removed, it would eliminate the possibility of a party remembering the existence of a contract, thereby avoiding perjury, but conveniently forgetting the quantity contained therein.

Finally, with regard to the point that the parol evidence rule does not apply, without more, to a writing used to satisfy the Statute of Frauds, the Task Force supports the recommendation to clarify this in the Comments.

*[PRELIMINARY REPORT - 2-202]*

**C. PAROL EVIDENCE RULE: § 2-202.**

*The parol evidence rule collides with the Code's broad definition of agreement in § 1-201(3). It operates to narrow the scope of the potential bargain in fact. This collision, however, arises when (and only when) the parties intend a writing to be the final expression of (to "integrate") part or all of the terms of the agreement. Section 2-202 is invoked to protect the parties intention to contract "out" of or discharge terms agreed to in prior or contemporaneous negotiations or terms derived from the surrounding commercial context.<sup>20</sup> It is a limitation upon the general definition of agreement in § 1-201(3) which depends upon a particular intention that a writing should be integrated in whole or in part.*

**Rec. A2.2 (3).**

*The consensus of the Study Group was that § 2-202 presented no major problems and, in general, was preferable to the more complex provisions of the Restatement, Second of Contracts.<sup>21</sup> A number of concerns exist, however, that might justify some revisions.*

*For example:*

---

20. For a clear and persuasive analysis in accord, see *A. Kemp Fisheries, Inc. v. Castle & Cooke, Inc.*, 852 F.2d 493, 495-96 (9th Cir. 1988)(maritime contract under California law).

21. §§ 209-218. It should be noted that § 2A-202 is the same as § 2-202. The absence of a parol evidence rule in CISG and the effect of Art. 8 are discussed in *J. Honnold, Uniform Law for International Sales § 110 (1982)*.

1. To what extent should a "merger" clause in a standard form contract be permitted to accomplish indirectly what cannot be done directly, e.g., the disclaimer of an express warranty. See § 2-316(1). Other than § 2-302, there is no explicit control over the risk of unfair surprise. A possible solution is to require that a "merger" clause in a standard form contract be "separately signed" by the party against whom the clause operates. See § 2-205.<sup>22</sup>

2. Can the line where the parol evidence rule stops and contract interpretation begins be drawn with greater clarity?<sup>23</sup> For example, suppose the court concludes that language in an integrated writing has a clear meaning and excludes evidence introduced to establish that the language has another, seemingly contradictory, meaning? Despite some authority to the contrary, it should be made clear, perhaps in the comments, that the extrinsic evidence is admissible if "relevant to prove a meaning to which the language is reasonably susceptible."<sup>24</sup>

3. In the absence of a merger clause,<sup>25</sup> what is the test to determine whether the parties intended a partial or total integration? Section 2-202 is silent and the courts have disagreed, especially over the test to determine whether there is a "consistent additional term."

(A) The Study Group agrees with the test in Comment 3: "If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact." We recommend that the Drafting Committee incorporate this language into the text of § 2-202.<sup>26</sup>

4. The ambiguous "unless" in § 2-202(b) should be clarified. Even if the parties have intended a complete and exclusive statement of the terms,

---

22. Another possible solution is § 211(3) of the Restatement, Second, Contracts, which provides: "Where the other party has reason to believe that the party manifesting [assent to a standardized agreement] would not do so if he knew that the writing contained a particular term, the term is not part of the agreement." For a general discussion, see Broude, *The Consumer and the Parol Evidence Rule: § 2-202 of the UCC*, 1970 Duke L.J. 881 (1970).

23. See Restatement, Second, Contracts § 214. Despite an integration, the parol evidence rule does not apply to disputes over whether a valid contract was ever formed or oral modifications of a written contract.

24. See *A. Kemp Fisheries*, *supra* note 20 at 495.

25. Note that the presence of a merger clause is not conclusive on whether the parties intended an integration. See *Sierra Diesel Injection Service, Inc. v. Burroughs Corp., Inc.*, 874 F.2d 653 (9th Cir. 1989).

26. Cf. Restatement, Second, § 216(2), which states that an agreement is "not completely integrated if the writing omits a consistent additional agreed term which is . . . such a term as in the circumstances might naturally be omitted from the writing." (Emphasis added).

*those terms still may be "explained or supplemented" by course of dealing, usage of trade and course of performance under § 2-202(a).*

*5. Is a general merger clause to which both parties have assented sufficient, without more, to exclude evidence of "course of dealing or usage of trade?" It is unclear from the statute, although most courts have held no.<sup>27</sup>*

*(B) We agree with this conclusion and affirm that usage of trade, course of dealing and course of performance are automatically part of the agreement unless identified in and explicitly negated by the writing. A general merger clause is not sufficient.*

[TASK FORCE - 2-202]

## SECTION 2-202

The consensus of the Study Group is that section 2-202 presents no major problems and, in general, is preferable to the more complex provisions of the Restatement (Second) of Contracts. Some minor revisions, however, are suggested.

The first Study Group recommendation concerns the impact of the cross-reference in section 2-316(1) to section 2-202 which, in the words of the Study Group, "raises the risk that a standard form 'merger' clause may exclude an express warranty made before the contract was signed, even though it is still part of the buyer's actual expectations."<sup>95</sup> Expressly declining to discard the cross-reference, the Study Group recommends that section 2-202 be

revised to ensure that the buyer is not unfairly surprised by the merger clause. One possible revision is to require that the merger clause be 'separately signed' by the other party. See sections 2-205 and 2-209(2). Another possibility is to draft a new comment requiring proof that the buyer expressly assented to the merger clause.<sup>96</sup>

In theory, a buyer should not be so prejudiced since, even with a merger clause, the writing should not be a bar to other testimony, "unless the court finds that the writing was intended

---

27. See Kastely, *Stock Equipment for the Bargain in Fact: Trade Usage, "Express Terms," and Consistency Under Section 1-205 of the UCC*, 64 N.C.L. Rev. 777, 785-96 (1986)(discussing the cases and arguing for an expanded trade usage).

95 Prelim. Rpt., Part 3, *infra* p. 1106.

96 Prelim. Rpt., Part 3, Rec. A2.3(12), *infra* p. 1106.

by both parties as a complete and exclusive statement of all the terms."<sup>97</sup> In theory, if a buyer does not know of the merger clause, the court could not make a factual finding of integration, and hence the testimony of warranty could not be foreclosed. This is problematic because a minority of courts accept a merger clause at face value,<sup>98</sup> and the frequency of such clauses in standard form contracts makes it worthwhile to re-examine the problem.

Of course, this is one of the problems endemic to adhesion contracts, especially consumer contracts. One non-Code approach is to attack the use of such a clause where the seller has reason to know that the buyer does not realize it exists or what it means, as an unfair or deceptive trade practice, or breach of duty of good faith.<sup>99</sup> That avenue, however, has not yet been widely explored.

The separate signing alternative<sup>100</sup> does not deal effectively with the adhesion contract situation. Sections 2-205 and 2-209(2), cited by the Study Group, are not at all comparable. The firm offer provision of section 2-205 will almost certainly be confined in practice to merchant-merchant transactions. While the language of the section 2-209(2) provision (authorizing a clause excluding modification unless by a writing) expressly contemplates application to a non-merchant (in which case the non-merchant must separately sign), it again seems most unlikely that it would affect many non-merchant transactions.

More to the point is that a separate signing requirement is likely to only add another formality to the standard form contract without materially affecting the result. It is a technique directed at the bargaining process that may have impact where a contract is a "joint creative effort." But what we are dealing with is "that which would be a contract except that no bargaining process really shapes it."<sup>101</sup> Consequently, efforts to control the result by tinkering with one detail of the process are likely to fail.<sup>102</sup> The Task Force strongly believes that this suggested option should be rejected.

---

97 See U.C.C. § 2-202 comment 3 (1990).

98 NATIONAL CONSUMER LAW CENTER, SALES OF GOODS AND SERVICES § 18.5.6 (2d ed. 1982 & Supp. 1990).

99 *Id.*

100 The alternative may have been prompted by the merger clause recommended by J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 2-12, at 111-12 (3d ed. 1988).

101 Leff, *Contract as Thing*, 19 AM. L. REV. 131, 143 (1970) (quoting the adhesion contract theorists).

102 Professor Leff observed:

The addition of a comment that the buyer expressly assented to the merger clause would be in the spirit of the present comment and would overcome the reluctance of some courts to see past the merger clause and permit the continued evolution of case law measuring the intent of the parties.<sup>103</sup>

The Study Group also referred briefly to the impact of a merger clause on implied warranties and recommended clarification by adding a new comment to section 2-202, which would read: "when, if ever, a general merger clause excludes an implied warranty of merchantability or fitness." Professor Honnold's early analysis seems still applicable:

The Code's parol evidence rule probably would not bar oral conversations which provide the basis of an implied warranty. Section 2-202 excludes parol evidence of additional or inconsistent "terms"; an implied warranty may not be a "term", which is defined in Section 1-201(42) as "that portion of an *agreement* which relates to a particular matter." Section 1-201(3) defines "*agreement*" as the "bargain in fact," including the language of the parties and "implication from other circumstances." It is doubtful that implications added by law are part of the "bargain *in fact*."<sup>104</sup>

It is not clear that there is a sufficient problem with this issue to warrant an additional comment.

---

[K]eeping in mind the nature, factual and legal, of the usual consumer-goods (or services) transaction, deal control is ordinarily a stupid option; it is silly to seek to shape and control the contours of a process that does not take place. [H]ow does one go about regulating the contract as process. By facilitating more bargaining? But that is absurd . . . .

*Id.* at 148.

In a footnote, Professor Leff referred briefly to the parol evidence rule problem: "It is even more ironic, perhaps, that even to the extent that there is a happening leading to the consumer contact, it is in any event to a large extent shielded from effective judicial scrutiny by the vestigial parol evidence rule." *Id.* at 147 n.54.

103 See, e.g., SALES OF GOODS AND SERVICES, *supra* note 98, § 18.5.

104 1 STATE OF NEW YORK REVISION COMMISSION REP.: STUDY OF THE UNIFORM COMMERCIAL CODE 412 n.104 (Hein & Co.) (1955). White and Summers agree that a merger clause "would not keep out evidence introduced to impose rights and duties that arise by operation of law. Implied warranties are the prime example." U.C.C. § 2-12. See also U.C.C. § 2-10, at 106.



The Task Force agrees with the perceived need to draw the line between the parol evidence rule and contract interpretation with greater clarity. The basic concern expressed by the Study Group is the line of authority which supports the traditional "plain meaning rule": if the court finds that the document is "clear on its face," parol evidence is not admissible to explain it. Many courts suggest that the Code should specifically clarify that extrinsic evidence is admissible if "relevant to prove a meaning to which the language is reasonably susceptible."<sup>105</sup>

The question presented is not whether the document is integrated and, therefore, whether the parol evidence rule applies, but whether, once it is determined that the rule does apply, the court must determine whether parol evidence is admissible to interpret the agreement when the agreement is arguably clear on its face.

The uniformity of the Code will certainly be enhanced by the clarification and adoption of one of these lines of authority to the exclusion of the other. The view expressed by the Study Group is clearly the majority view and the prevalent trend.<sup>106</sup> And although there is still recent authority in support of the "plain meaning rule,"<sup>107</sup> the fact that few judges appear to give any credibility to the notion of language being clear, in and of itself, outside the context in which it is used, militates toward the adoption of the standard proposed.

Another Study Group suggestion is that the "certainty" test of Comment 3<sup>108</sup> be incorporated into the text of the section. The problem has always been not in the articulation of a test for integration, but in the application of this test. Hundreds of cases show the struggle of courts trying to resolve the question of whether a document is integrated or not. It will probably make little dif-

---

105 *A. Kemp Fisheries, Inc. v. Castle & Cooke, Inc.*, 852 F.2d 493, 495 (9th Cir. 1988) (quoting *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 442 P.2d 641, 644, 69 Cal. Rptr. 561, 564 (1988)).

106 *See, e.g.*, E. FARNSWORTH, *CONTRACTS* 520-28 (2d ed. 1990).

107 *See, e.g.*, *Trident Center v. Connecticut Gen. Life Ins. Co.*, 847 F.2d 564, 569 (9th Cir. 1988) ("We question whether this [majority] approach is more likely to divulge the original intention of the parties than reliance on the seemingly clear words they agreed upon at the time.").

108 "If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact." U.C.C. § 2-202 comment 3 (1990).

ference whether the test is articulated in the Code itself or in the comments to the Code.

A further Study Group recommendation is that "the ambiguous 'unless' in section 2-202(b) should be clarified." The point is this: section 2-202 always allows parol evidence to explain or supplement an agreement which is not integrated. The question is to what extent parol evidence can be admitted to supplement an integrated agreement. The structure of the section would imply that course of dealing, usage of trade and course of performance can supplement even an integrated agreement. This result is based on the fact that the effect of integration on the admissibility of additional terms is contained in section 2-202(b), and not in section 2-202(a), which permits the use of course of dealing, usage of trade and course of performance to supplement an agreement, even though other types of parol evidence would not be admissible to supplement an integrated agreement. It is unclear as to why this is ambiguous. This result would appear to be fairly obvious from the Code in its present form.

Finally, the Study Group recommends that steps be taken to make clear that a general merger clause to which both parties have assented, without more, is insufficient to exclude course of dealing and usage of trade. This view is supported by a majority of the courts and appears to be implicit in the comments.<sup>109</sup> This view is also evident from the structure of the section itself, i.e., the section which allows for the admission of course of dealing and usage of trade section (a) is set out separately from the section which deals with integration by merger clauses (section (b)). Thus, the Report's suggestion that a merger clause, without more does not operate as a bar to the admission of evidence regarding course of dealing or usage of trade, is consistent with the apparent meaning of the Code and the prevalent view of the courts. To the degree that this is not clear in the Code, the suggestion that it should be clarified is sound.

---

109 The comment to Section 2-202 states:

Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased.

U.C.C. § 2-202 comment 2 (1990).

[PRELIMINARY REPORT - 2-203]

D. SEAL INOPERATIVE: § 2-203.

*No revisions are recommended in § 2-203.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-204]

E. FORMATION IN GENERAL: § 2-204.

*No major revisions are recommended in § 2-204.*

Section 2-204, a core provision in Article 2's formation provisions, eliminates formal requirements in the manner and timing of formation and recognizes "conduct by both parties" as primary evidence of intention. It also empowers parties who "have intended to make a contract" to create a contract even though material terms are indefinite or not agreed, if there is "a reasonably certain basis for giving an appropriate remedy." § 2-204(3) This latter approach, although sometimes difficult to apply in particular cases,<sup>28</sup> is also adopted in § 33 of the Restatement, Second, of Contracts.

*Rec. A2.2 (4).*

*A possible revision to § 2-204(3) would substitute the language "parties have intended to conclude a bargain" for "intended to make a contract." It is unlikely that the latter intention is present in most cases and doubtful that it should be required.<sup>29</sup>*

[TASK FORCE - 2-204]

SECTION 2-204

The Study Group's only recommendation is to change the language in section 2-204 from "intended to make a contract" to "parties have intended to conclude a bargain," because it is un-

---

28. An important example is *Bethlehem Steel Corp. v. Litton Industries, Inc.*, 507 Pa. 88, 488 A.2d 581 (1985), where, after several appeals, a divided court upheld the decision of the trial court that the failure to agree on a price escalation clause meant that the parties did not intend to contract at all.

29. See *Kleinschmidt Div. of SCM Corp. v. Futuronics*, 41 N.Y.2d 972, 363 N.E.2d 701, 702-03 (1977), where the court stated that the basic question under § 2-204(3) is whether the parties have reached a basic agreement: "Without agreement there can be no contract, and, of course, without a contract there can be no breach. This principle, basic as it is to contract law, finds explicit recognition in the . . . Code."

likely that the former intention is present in most cases, and it is, therefore, doubtful that it should be required.

The reason for the change is that the operative point under which Article 2 becomes effective through this section is the point that the parties intend to enter into an agreement,<sup>110</sup> and not the point when the parties have the intent to contract,<sup>111</sup> and "[w]ithout agreement there can be no contract."<sup>112</sup> Thus, the current text of section 2-204 appears to put the cart before the horse. This suggested change would make the text of section 2-204 consistent with the usage of the concepts of agreement and contract which are set out elsewhere in the Code.

[PRELIMINARY REPORT - 2-205]

F. FIRM OFFERS: 2-205.

*No revisions are recommended in the text of § 2-205.*

*No important issues of practical consequence appear to have arisen under § 2-205. We have no evidence on how the section is used or misused in practice.*

*Rec. A2.2 (5).*

*A possible clarification for the comments is that § 2-205 is not intended to displace other methods of creating options, e.g., through the use of consideration or by reliance. See § 1-103. Properly interpreted, § 2-205 is simply an additional, formal method to create an option.*

[TASK FORCE - 2-205]

SECTION 2-205

The Study Group does recommend that the comments to section 2-205 clarify the fact that this section does not operate to displace any other method of creating options, but merely is an additional method. Although this appears to be generally recog-

---

110 The Code defines an "agreement" as "the bargain of the parties in fact as found in their language or by implication from other circumstances . . . ." U.C.C. § 1-201(3) (1990).

111 The Code defines a "contract" as: "the total legal obligation which results from the parties' agreement." U.C.C. § 1-201(11) (1990).

112 *Kleinschmidt, Div. of SCM Corp. v. Futuronics*, 41 N.Y.2d 972, 973, 363 N.E.2d 701, 702-03, 395 N.Y.S.2d 151, 152 (1977).

nized, such an addition to the comments or a clarification of the text could only help guide courts in their decisions.

*[PRELIMINARY REPORT - 2-206]*

**G. OFFER AND ACCEPTANCE IN FORMATION OF CONTRACT: § 2-206.**

*Litigation under § 2-206 is sparse and the Study Group is tempted to leave well enough alone. Nevertheless, the Drafting Committee should consider the following possible revisions to text or comment.*

**1. Rec. A2.2 (6)**

*A new Comment providing working definitions of offer and acceptance could be prepared. These definitions, drawn, perhaps, from the Restatement, Second, of Contracts, should be consistent with the policy of § 2-204 and would apply to all sections where the words "offer" and "acceptance" are used.*

*2. Section 2-206(1)(a) provides an acceptable rule of construction for determining the manner and medium of acceptance. There is, however, no indication when an acceptance is effective. Does § 2-206 embrace the so-called "mailbox rule?" This omission may also cause problems in an age of quasi-instantaneous communication through electronics. Should the contract be formed when the impulse is transmitted or received? What are the justifications for concluding that any offer is accepted at the time the acceptance is transmitted?*

**Rec. A2.2 (7).**

*The Drafting Committee should, in a Comment to § 2-206(1), state clearly when, if ever, an acceptance that is made in a manner or medium "reasonable in the circumstances" is effective before being received.*

*3. The problem of the nonconforming shipment, treated in § 2-206(1)(b), raises an interesting issue<sup>30</sup> (e.g., how to deal with a nonconforming shipment sent intentionally with the purpose to speculate on the market) and proposes a rather unorthodox solution (e.g., to treat the shipment as both an acceptance of the offer and a breach of contract unless the seller satisfies the notice of*

---

*30. Section 2-206(1)(b) is designed to avoid what Llewellyn called the "unilateral contract trick:" If an offer required full performance for acceptance, a nonconforming performance at common law was always a rejection and a counteroffer. If the market moved up before the counteroffer was accepted, the offeror had power to avoid a contract by a prompt revocation.*

*accommodation condition). The remedial complexities of that solution are not elaborated in either the text or comments.<sup>31</sup> Nevertheless, the subsection has been ignored by the courts and no revisions are needed.*

*4. Section 2-206(2) attempts to cover in one sentence a problem (e.g., how to accept an offer inviting a bilateral contract by "beginning. . . a requested performance") which the Restatement, Second covers in several separate, complex sections. Nevertheless, there has been no important judicial activity under § 2-206(2) and no other reasons for revision have emerged. Although the "notice/lapse" issue poses analytical problems,<sup>32</sup> no revision is warranted.*

*5. Is the relationship between § 2-206 and § 2-207 clear enough? The Study Group was uneasy about the answer, but no specific solution is recommended.*

#### [TASK FORCE - 2-206]

#### SECTION 2-206

The Task Force does not favor the drafting of a new comment that provides working definitions of offer and acceptance.

Currently, the Code does not define offer or acceptance, and therefore one must look to the common law of contract to define these terms.<sup>113</sup> This has never caused any problem under the Code, and it is unclear why a definition of offer and acceptance is now necessary.<sup>114</sup>

Although it provides an acceptable rule of construction for determining the manner and medium of acceptance, section 2-

---

31. Nor do we learn what to do if there is a "prompt promise" to ship nonconforming goods.

32. § 2-206(2) states that if an offeree employs a "reasonable mode of acceptance" but the offeror is not notified of "acceptance within a reasonable time," the offeror may treat the offer as having lapsed before acceptance. How can an offer lapse after it has been accepted? A better solution is to treat notice as a condition to the offeror's duty under an enforceable contract: Failure to provide notice within a reasonable time after part performance excuses the duty and, thus, the contract. Cf. Restatement, Second, Contracts § 54.

113 U.C.C. § 1-103 (1990).

114 One possible suggested set of definitions proposed by the Report are those given in the Restatement (Second) of Contracts, which defines an offer as "the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it," RESTATEMENT (SECOND) OF CONTRACTS § 24 (1981), and an acceptance as "a manifestation of assent to terms thereof made by the offeree in a manner invited or required by the offer." *Id.* § 50.1. Neither of these definitions give any clarity or guidance to the factual issues which embody offer and acceptance problems.

206(1)(a) does not mention when an acceptance becomes effective. The Study Group suggests that a comment to section 2-206 should be drafted to explain when, if ever, an acceptance is effective before being received.

This recommendation addresses the question of the "mailbox rule's" applicability to section 2-206, particularly as it applies to electronic transfers. The Report does not suggest under what circumstances, if any, acceptances should be effective before receipt, rather it only suggests that such circumstances be specified in a comment. It may be, however, that the circumstances which might justify the effectiveness of an acceptance before receipt are so fact sensitive that it should not be reduced to a rule of application. Possibly a broad guideline such as "when it is reasonable to place the risk of receipt of acceptance upon the offeror, acceptance will be effective upon dispatch of the acceptance in a reasonable manner," will suffice.

Some Task Force members are of the opinion that because section 2-206 is silent on the point, the mailbox rule applies by virtue of section 1-103. Furthermore, some members see no particular problem in applying the mailbox rule under modern conditions because: (1) the rule, by its name, is primarily applicable when the parties use the mail or other non-instantaneous methods of communication, and (2) the rule's basic rationale, which places the contractual uncertainty and risk of loss in transmission on the offeror, is the same regardless of the method used to communicate the acceptance.

#### *[PRELIMINARY REPORT- 2-207]*

#### *H. ADDITIONAL TERMS IN ACCEPTANCE OR CONFIRMATION: 2-207.*

*Section 2-207 is controversial, complex and frequently litigated.<sup>33</sup> The problem addressed in § 2-207 is created by the use of standard forms in commercial transactions. The claim is that in these transactions, the common law "mirror image" rule both (1) prevented the formation of contracts where*

---

*33. See Revision at 422-36, for an excellent analysis and treatment of the cases.*

both parties thought they were bound,<sup>34</sup> and (2) created the opportunity for one party's standard terms to become part of the contract even though the other party did not negotiate over and was not aware of them.<sup>35</sup> Section 2-207 was designed to deal with these problems.

Experience under § 2-207, however, suggests that the dominant issue has been not whether some contract has been formed, but, rather, what are the terms of that contract? The primary problem, therefore, is to exclude from the contract material terms to which there has been no express assent. Arguably, § 2-207 does this imperfectly, if at all.<sup>36</sup>

**Rec. A2.2 (8).**

The Study Group concluded that a major revision of § 2-207 is required. In our judgment, the revision should emphasize the following:

1. The revision should draw on and be consistent with the underlying policies of Article 2, Part 2, particularly § 2-204;
2. The formula now contained in § 2-207(3) should be emphasized;<sup>37</sup>

---

34. For example, assume that after preliminary negotiations, Buyer makes an offer to Seller, delivery in three months. Seller mails an acknowledgment which clearly assents to Buyer's offer but also contains a standard form disclaimer of all implied warranties. Three months pass, the market has risen and Seller, claiming that no contract was formed, refuses to deliver. At common law, the acknowledgment was a counteroffer and the same result follows under § 58 of the Restatement, Second, Contracts. Under § 2-207(1), the acknowledgment creates a contract "unless acceptance is expressly made conditional on assent to the additional or different terms." This reverses the common law presumption that any additional or different term indicated that the offeree did not intend to conclude the bargain unless the offeror agreed to those terms.

35. Buyer sends an offer to Seller who sends an acknowledgment which accepts the offer and contains additional or different standard form terms and ships the goods. Buyer, without objecting to the standard form terms, accepts and pays for the goods. At common law, Seller's acknowledgment was a counteroffer and Buyer's conduct was an acceptance of the counteroffer, including the standard form terms. Under § 2-207(1), the acknowledgment plus shipment of the goods creates a contract and the standard form terms are proposals for addition to the contract. Whether they become part of the contract is determined under § 2-207(2).

36. Cf. Article 19 of CISG, which distinguishes additional or different terms that materially alter the terms of the offer from those that do not. Assuming in both cases that the reply purports to accept the offer, material terms create a counter-offer and non-material terms do not prevent the formation of a contract. This solution should be rejected by the Drafting Committee.

37. In essence, if both parties, by conduct or otherwise, recognize the existence of a contract a contract for sale exists "although the writings of the parties do not otherwise establish a contract." But what are the terms of this contract? Under § 2-207(3), the consist of "those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act."

In endorsing this approach, the Study Group assumed that the "supplementary terms" are balanced and otherwise fair.



3. *The parties should have power to "contract out" of any revised § 2-207; and*

4. *Fortuities of timing in the use of standard forms should be irrelevant.*

*Specifically, we recommend that the Drafting Committee consider a proposal by Professor John E. Murray, Jr., which gives effect to the factual bargain of the parties and the "supplemental terms" in Article 2, Part 3 rather than any "additional or different terms" contained in standard forms.<sup>38</sup> The concept of the "newly designed" § 2-207 can be derived from the model below:*

*2-207. Factual Bargains Made Operative.*

*(1) If a court finds exchanged written manifestations of an intention to be bound to an agreement or one or more written confirmations of a prior oral agreement they will be operative notwithstanding variations in the terms of the writing(s) if there is a reasonable basis for giving a remedy. The terms of the resulting contract will be the terms the parties have consciously considered and the standard terms of this Act. Terms deviating from the standard terms of this Act will be operative only in accordance with subsections (2) and (3).*

*(2) Immaterial deviations from the standard terms of this Act will become part of the contract if the party seeking to include such deviations establishes their immateriality and the writing of the other party does not limit the terms of the resulting contract to the terms of that writing.*

*(3) Material deviations from the standard terms of this Act will become part of the resulting contract if the party seeking to include such deviations establishes that the other party understood or reasonably should have understood such deviations and that such deviations would become part of any resulting contract to which that party expressed assent through language or conduct.*

*(4) If the Court finds that the writings of the parties clearly do not manifest a factual bargain or that there is no basis for affording a remedy for any factual bargain manifested by the writings, should the parties proceed to perform as if there were a contract, the terms of the resulting contract by conduct will be the express*

---

38. Murray, *A Proposed Revision of Section 2-207 of the UCC*, 6 J.L. & Com. 337 (1986). The background for Professor Murray's proposal is contained in Murray, *The Chaos of the Battle of the Forms: Solutions*, 39 Vand. L. Rev. 1307 (1986).

*terms on which the writings of the parties agree and the standard terms of this Act.*

[TASK FORCE - 2-207]

## SECTION 2-207

Clearly some revision of section 2-207 is necessary as the existing text contains many interpretive difficulties. The better procedure for revising the section is to build on what has been done by amending the existing text rather than, as the Study Group seems to recommend, to start all over again. There are several reasons for preferring amendment to starting anew. First, much of section 2-207 works well in practice. For example, the section produces predictable results in two situations: (1) written confirmation of prior informal agreements, and (2) offer and acceptance by exchange of non-form correspondence. Second, it is easier to cure existing problems without creating new problems by amending the existing text rather than drafting it anew. Third, the accumulated case law under section 2-207 provides a context for construing that section. Though the caselaw is in disarray, it at least focuses a person on the problems of the "Battle of the Forms." A complete redraft of the section would sever it from that focus to a much greater degree than amendments would.

The revisers of section 2-207 must address two issues: (1) deal welshing, and (2) fairness of the terms of any contract resulting from section 2-207. Fairness of terms is by far both the most important and perplexing of these issues. Most of the difficulties with the present section 2-207 have been caused by the fact that it often hinders courts from finding contracts on fair terms. Any revision of section 2-207 that does not take account of this fact is doomed. Thus, it is disheartening to see that the Study Group's recommendations are premised on the assumption that the Code gap filler terms are balanced and fair.<sup>115</sup> In fact, these supplementary terms are not balanced and fair in the Battle of the Forms context; they favor the buyer. The Task Force recommends that the Drafting Committee consider several matters in revising section 2-207.

1. *The Section Should be Put on a Sound Doctrinal Footing.* The underlying reason and purpose for the section must be clearly

---

115 Prelim. Rpt., Part 2 n.37, *supra* p. 1055.

stated in its Comments. What now passes for the reason and purpose, "a proposed deal which in commercial understanding has in fact been closed is recognized as a contract,"<sup>116</sup> is useful for resolving the deal welsher issue. However, it fails to provide guidance on the fairness of terms issue. Thus, courts have found purchase orders drafted as offers to be acceptances making a contract on the seller's terms;<sup>117</sup> acknowledgement forms which by any reasonable interpretation do not manifest assent to all of the buyer's terms to be acceptances making a contract on the buyer's terms;<sup>118</sup> and buyer conduct in accepting goods knowing full well of the seller's terms, to make a contract containing not the seller's terms but standard Code gap fillers.<sup>119</sup>

The task is to formulate a principle that specifies when the contract is to be formed with jointly agreed upon terms and standard gap fillers (or specially drafted gap fillers for forms battles) and when, if ever, it is proper for one party's terms to prevail. This is far from easy.

2. *Deal Welshing*. The prevailing view of subdivision 2-207(1) is that it covers offer and acceptance by the exchange of non-matching forms.<sup>120</sup> Thus, under this view, if the offeree responds to a form offer with his or her own form containing dickered terms identical to those in the offer, along with pre-printed terms which are additional to or different from the terms of the offer, the responding form constitutes an acceptance (assuming it does not contain the required expressly conditional language). This result abrogates the common law general rule that a response must mirror the offer to constitute an acceptance. It has been said that the reason for changing the rule is to prevent a party who has made a deal from avoiding liability ("welshing") on the ground that a

---

116 U.C.C. § 2-207 comment 2 (1990).

117 *Reaction Molding Technologies, Inc. v. General Elec. Co.* 588 F. Supp. 1280, 1285-91, 38 U.C.C. Rep. Serv. (Callaghan) 1537 (E.D. Pa. 1984).

118 *Construction Aggregates Corp. v. Hewitt-Robins, Inc.* 404 F.2d 505, 509, 6 U.C.C. Rep. Serv. (Callaghan) 112 (7th Cir. 1968).

119 *Diamond Fruit Growers, Inc. v. Krack Corp.*, 794 F.2d 1440, 1445, 1 U.C.C. Rep. Serv. 2d (Callaghan) 1073 (9th Cir. 1986).

120 The drafting history of U.C.C. § 2-207 is remarkably silent on whether subsection (1) was intended to cover offer and acceptance by exchange of non-matching forms.

contract was not formed, because the response did not sufficiently match the offer.<sup>121</sup>

The revisers of section 2-207 can take one of two approaches to the deal welshing problem. They can regulate deal welshing within revised section 2-207 or regulate deal welshing in a section separate from revised section 2-207. These two approaches are discussed below.

a. *Regulating Deal Welshing Within Revised Section 2-207.*

It is generally believed that the main purpose of subdivision 2-207(1) is to prevent a party from welshing on a deal by asserting that, since the exchanged forms do not match, no contract was made. In practice, subdivision 2-207(1) has created more problems than it has solved.

The response of many (perhaps most) buyers and sellers to subdivision 2-207(1) has been to draft their pre-printed forms to avoid that subdivision. Thus, their forms routinely include language stating that only their terms are to be included in any contract, or that any acceptance is expressly conditioned upon the other party's assent to all their terms. In effect, the parties contract out of subdivision 2-207(1).<sup>122</sup>

One reason for this response is that there is some uncertainty as to what are the terms of a contract formed under subdivision 2-207(1).<sup>123</sup> This uncertainty provides a powerful incentive to avoid the application of that subdivision. Thus, an offeree realizing that a court could construe the contract to consist of the offeror's terms (the "First Shot" rule) will want to avoid that result. Similarly, an offeror concerned that a court might construe the contract resulting from the exchanged forms to exclude his terms,<sup>124</sup> will want to avoid that result as well.

---

121 See, e.g., J. MURRAY, MURRAY ON CONTRACTS 162-63 (3d ed. 1990); J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 29-30 (student ed. 1988).

122 Cf. Grant Gilmore's experiences with corporate counsels. Letter from G. Gilmore to R. Summers (Sept. 10, 1980) at 2; reprinted in R. SPEIDEL, R. SUMMERS & J. WHITE, COMMERCIAL LAW: TEACHING MATERIALS 468 (4th ed. 1987).

123 See, e.g., WHITE & SUMMERS, *supra* note 121, 33-34 (discussing dispute between co-authors as to what are the terms of the contract).

124 A court might apply the "knockout" rule. See WHITE & SUMMERS, *supra* note 121, 33-34. Also, it might manipulate the rules on offers so that the buyer's form (if sent first) does not constitute an offer.

The Study Group has recommended emphasizing the subdivision 2-207(3) formula for determining the resulting contract's terms. This recommendation will both dispel the uncertainty that now exists and minimize the possibility of a court finding a contract solely on one side's terms. Unfortunately it is likely that buyers and sellers will continue to contract out of the rule recommended by the Study Group. This is so for several reasons: First, the supplementary terms supplied by the Code, which the subdivision 2-207(3) formula would read into the contract, often give to the buyer more than the seller would have been willing to concede.<sup>125</sup> Therefore, the seller will still have a strong incentive to avoid the recommended rule. Second, it is in the best interest of the party who sends the first form (the offeror) to avoid the recommended rule, because the offeror will not know in advance what the resulting terms of the contract will be. Under the recommended rule, the terms of the contract would depend upon the contents of the responding form. Thus, under the recommended rule, the offeror can be bound to a contract although the terms of the contract will be unknown to him until after he is bound. Since buyers tend to be offerors, buyers will draft their forms to avoid the recommended rule. Since the seller's form sometimes constitutes the offer, sellers will have this additional reason to draft out of the recommended rule. Thus, both buyers and sellers will have legitimate reasons to be dissatisfied with the recommended rule. They will, therefore, draft their forms to avoid that rule.

Any solution that chooses to regulate deal welshing within revised section 2-207 must respond to these concerns of buyers and sellers. The concern of offerors that they can be bound to contracts, the terms of which they cannot know until after they are bound, could be met by giving offerors the right to avoid a

---

125 See, e.g., WHITE & SUMMERS, *supra* note 121, at 43 (stating that contract formed under subdivision (3) may disadvantage seller); Macaulay, *The Use and Non-Use of Contracts in the Manufacturing Industry*, 9 PRAC. LAW. NO. 7, 13, 35-36 (1963) (Standard Code terms give buyers extensive warranty coverage and consequential damages which sellers routinely seek to limit). This point was not lost on the Code drafters. Compare the Code's treatment of standard warranty and remedy terms: Buyer generally obtains a warranty (see U.C.C. §§ 2-314 to -316) and full remedies (U.C.C. §§ 2-711(1) to -711(2)) with the treatment of additional terms in a form: Warranty disclaimer materially alters the contract and thus is not included; reasonable repair or replacement remedy clause does not materially alter the contract and is included (see U.C.C. § 2-207 comments 4, 5).

contract by objecting to the contract within a reasonable time after receiving the offeree's forms. The concern of sellers that the standard code gap fillers disfavor them could be met by redrafting more balanced standard gap fillers (or by drafting special gap fillers for revised section 2-207).<sup>126</sup>

b. *Regulating Deal Welshing in a Section Separate from Revised Section 2-207.*

The deal welshing problem occurs when one side refuses to perform for reasons having nothing to do with the non-matching terms in the forms. Thus, for example, a party may welsh on a deal for a quantity of goods at an agreed upon price, because subsequent market price shifts make that price or quantity unattractive. The real reason for refusing to perform is dissatisfaction with the price term, a term both parties actually assented to. On the other hand, if the reason for refusing to perform is dissatisfaction with a non-matching term, then perhaps the refusal is justified. Suppose, for example, a seller refuses to ship the goods for the stated reason that the buyer has not agreed to warranty and remedy limitation terms proposed by the seller. The seller's real reason for not shipping may be dissatisfaction with the price because of a market shift. Is not the seller's true motive a question of fact? If the buyer successfully convinces the fact-finder that an unattractive price was the seller's true reason for refusing to ship, the buyer should prevail. Why not, then, treat the welsher problem as a question of fact? If a case of welshing is established, then the welsher would be precluded from asserting lack of contract.

To accomplish this result, the Drafting Committee could draft a separate section dealing with the deal welsher in the exchange of forms context. This approach has the advantage of focusing on the specific problem of deal welshing. The present rule suffers from being both over-inclusive and under-inclusive. It catches not only the welsher but also a host of parties who, far from welshing on a deal, have performed and now may find themselves stuck with the other party's terms. Neither the present rule nor the recommended rule will catch a deal welsher who has been crafty enough to include appropriate language in his form that prevents the formation of a contract under subdivision 2-207(1). The rule should

---

126 See *infra* text accompanying notes 144-45 (discussing this approach).

fit the problem. A separate section can be tailored to just the welshing problem without also being concerned with the terms of the resulting contract. Freed from concerns about welshing, the revisers can then concentrate on ensuring that the terms of any resulting contract are fair.

3. *Fairness of Contract Terms.* This is the engine that drives contract formation law, including section 2-207. The fact-specific nature of contract formation cases is often obscured by the popularity of seemingly simple rules of offer and acceptance, such as the Mirror Image rule and the Last Shot rule.<sup>127</sup> However, the simplicity of the rules is belied by the jumbled case law existing at common law and under section 2-207. That caselaw represents nothing more than the courts' attempts to reach fair results based upon the facts before them.

In the battle of the forms context where the parties have agreed to only a few terms and disagreed over the rest (by exchanging non-matching forms), but nevertheless intend an agreement, the task of a court is to fill the gaps in the agreement. The court must construct terms on the disputed points. In so doing the court has recourse to an old maxim: Where the parties have failed to agree on a particular term necessary to resolve a dispute, the court will imply a reasonable term.<sup>128</sup>

The success of any section 2-207 revision is directly dependent upon how well the revision permits courts to fill gaps with reasonable terms. The present statute fails this test. First, the text of present subdivision 2-207(1) appears to substitute the tyranny of a First Shot rule for the tyranny of the pre-Code Last Shot rule.<sup>129</sup>

---

127 See Gedid, *A Background to Variance Problems Under the U.C.C.: Toward a Contextual Approach*, 22 DUQ. L. REV. 595 (1984) (describing the extent to which the courts avoided Mirror Image and Last Shot Rules under pre-Code law).

128 E.g., 1 W. PAGE, *THE LAW OF CONTRACTS* 230-33 (2d ed. 1920). Cf. A.L.I. Minutes of the Revised Uniform Sales Act Conference, New York City, at 31 (Nov. 22-24, 1942) (available in A.L.I. Archives, Philadelphia, Pa., drawer 182, File: Sales Act, Conference, (Nov. 22-24, 1942)) (Llewellyn explaining when terms in a memorandum should become part of the contract under early draft of what is now § 2-207: "Both oral deals and wire deals are constantly followed by written confirmations, including highly reasonable terms. When those terms are highly reasonable and not objected to, the tendency of the courts has been to read them right in. I am all for that tendency.").

129 The "First Shot" interpretation is the prevailing view of what U.C.C. § 2-207(1) means. It may not reflect what the drafters intended. See *supra* note 120.

Second, the text is silent on whether the Last Shot rule survives at all where, for example, the seller's Last Shot form clearly calls to the buyer's attention reasonable terms which the seller is insisting be part of the contract, and the buyer then accepts the goods. Third, the standard Code gap fillers, which supply terms in the mutual conduct-based contract situation,<sup>130</sup> favor the buyer.<sup>131</sup>

The Study Group's recommendation to emphasize the subdivision 2-207(3) formula will cure the first problem. The second problem implicates not only the "counter-offer riddle"<sup>132</sup> but also, if deal welshing is covered in a revised section 2-207, the question of what response by the offeree will avoid a contract by exchange of forms. In short, the second problem raises the question of what a party must do to contract out of subdivisions 2-207(1) and (3). The third problem implicates not only subdivision 2-207(3) but the courts' timid attitude toward trade usage. Solutions to the second and third problems will now be addressed.

a. *Contracting Out of Section 2-207.*

To determine what a party must do to avoid the application of section 2-207, one should consider the reasons why special contract rules are necessary for the battle of the forms. The premise that underlies section 2-207 is that pre-printed boilerplate terms in each party's form are not read. Indeed, they cannot reasonably be expected to be read, by the other party.<sup>133</sup> This is the true source of the distinction between dickered terms and boilerplate terms. Dickered terms, which are handwritten or typed, reasonably come to the attention of the other party. Boilerplate terms, which are pre-printed often in dense columns of small type, do not.<sup>134</sup>

---

130 U.C.C. § 2-207(3) (1990).

131 See *supra* text accompanying note 125.

132 See Murray, *The Chaos of the "Battle of the Forms": Solutions*, 39 VAND. L. REV. 1307, 1322 (1986).

133 Selected Comments to Uniform Revised Sales Act: General Comment on Parts II and IV: Formation and Construction 9 (1948), in the Llewellyn Papers file J(IX)(2)(a) [hereinafter General Comment] (reproduced in App. A). Cf. K. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 370 (1960).

134 It has sometimes been asserted that dickered terms are vital, that is, more important, than anything in boilerplate terms. But the decision to pre-print terms or to leave blanks to be filled in later does not turn on the relative importance of the two types of terms. Rather, it turns on the practical fact that blank terms must be left blank because they must vary from deal to deal. By their very nature they cannot be standardized and must be dickered.



Thus, if a term has reasonably been called to the other party's attention, it is not the kind of different or additional term that section 2-207 is intended to cover, and it is not a term that should be ignored.<sup>135</sup> In other words, a conspicuous<sup>136</sup> term in a form, whether the term is handwritten, typed, or pre-printed, should have the same legal effect that it would have outside the battle of the forms. This is the principle that should guide the Drafting Committee's determination of what a party must do to avoid the application of section 2-207.

(1) *When a Response is Not an Acceptance: Contracting Out of Subdivision 2-207(1).*

Assume, for example, that the buyer sends a form offer, and the seller responds with a form agreeing with the buyer's dickered terms plus a cover letter stating that he accepts the buyer's offer, but that the seller's limitation of remedy term (which is set forth in the letter) is part of the ensuing contract. The seller's response should not constitute an acceptance. Under pre-Code and non-Code law, where a response manifested assent to the offeror's terms but included conspicuous major<sup>137</sup> additional terms, most courts have not found the response to be an acceptance. The same result should follow under subdivision 2-207(1). Similarly, if the remedy limitation terms were handwritten, typed or conspicuously pre-printed on the form response instead of in a separate cover letter, the seller's response should not be an acceptance.

If the response conspicuously stated that it was expressly conditional on the offeror's assent to any different or additional terms in the response, this also should prevent the response from being an acceptance. Similarly, if the offer conspicuously stated that acceptance was limited to the terms of the offer, or if the offer contained conspicuous terms that were different from or major

---

<sup>135</sup> Cf. General Comment, *supra* note 133, at 13-14.

<sup>136</sup> "Conspicuous" is defined in U.C.C. § 1-201(10) (1990). The present definition may need revision along two lines: (1) to ensure that the language of the term is reasonably understandable, and (2) to deal with the problems of terms on the reverse side of the form and crowded terms on the front of the form.

<sup>137</sup> Minor additional terms should not prevent the response from being an acceptance. Cf. U.C.C. § 2-207 comment 1 (1990) (referring to letter or wire expressed and intended as acceptance that adds further minor suggestions). This reflects pre-Code law. PAGE, *supra* note 128, 264-65.

additions to the response, the response should not be deemed an acceptance. In sum, no contract should be formed under subdivision 2-207(1) if a response contains a conspicuous major additional (or different) term.

(2) *Resolving The Counter Offer Riddle: Contracting out of Subdivision 2-207(3).*

The counter-offer riddle is this: Assuming that a response to an offer does not operate as an acceptance under subdivision 2-207(1), when is that response a counter-offer, and when is the response merely a prelude to a conduct-based contract under subdivision 2-207(3)? This distinction is significant, for if the response is a counter-offer, an offeree who is a buyer might be held to have accepted the terms of the counter-offer by accepting the goods. If the response is merely a prelude to a conduct-based contract under subdivision 2-207(3), then an offeree/buyer who accepts the goods makes a contract on terms common to the exchanged forms. The solution proceeds along the lines of the principle outlined above. If the response conspicuously called to the buyer's attention the specific terms of the seller, the buyer should be bound by those terms if he later accepts the goods. Thus, this type of response should be a counter-offer. However, acceptance of the goods should bind the buyer to just the conspicuous terms, not all of the terms in the seller's response. Any other response by the seller is merely a prelude to a conduct-based contract under subdivision 2-207(3). Examples of such other responses include a response with no conspicuous terms, and a response with a conspicuous, expressly conditional term but no other conspicuous terms.

It may be objected that this solution resurrects the Last Shot rule and that this is unfair to the buyer. To this objection there are two replies: First, the buyer is bound only by terms that are conspicuous. Outside the battle of the forms, buyers would be bound under similar circumstances, so they should be bound here.<sup>138</sup> Second, the solution recommended above provides the seller (as present section 2-207 and the Study Group's recommendations do

---

138 If there is a practical difficulty that the department accepting the goods is not the same department that negotiates and reviews the terms, this difficulty can be dealt with by permitting the buyer a reasonable time after he accepts the goods to object to the seller's terms and revoke his acceptance. Cf. Revised Article 3 - Negotiable Instruments § 3-311(2) (1990).

not) with a means to avoid standard Code gap-fillers which are often not to the seller's liking.<sup>139</sup>

b. *Trade Usage as Modifying Standard Code Gap-Fillers.*

Under the present subdivision 2-207(3) formula, a conduct-based contract consists of terms on which the parties' writings agree plus standard Code gap-fillers. The problem with this approach is that the standard Code gap-fillers usually favor the buyer.<sup>140</sup> This problem could be ameliorated if courts were willing to employ trade usage and course of dealing to modify the standard Code gap-fillers. There is no doubt that relevant trade usage and course of dealing do displace standard Code gap-fillers.<sup>141</sup> However, as the Study Group report recognizes, courts have been rather timid here.<sup>142</sup> Perhaps the answer is to reconsider Llewellyn's proposals for advisory merchants' panels on questions of trade usage. These proposals, together with the N.C.C.U.S.L. Annual Conference Committee of the Whole discussion of them are included in the Appendix to this report and are briefly discussed in the section of this report under section 1-205.<sup>143</sup>

c. *Special Balanced Standard Terms for Battle of The Forms.*

Alternatively, the Study Group might consider recommending more neutral gap filler terms to be used in battle of the forms situations. Standard gap fillers, appropriate where neither party has attempted to negotiate a term, may not be appropriate where one or both parties have conspicuously insisted on a term but did not reach agreement on the term.

Thus, for example, where the parties' negotiations and forms have been silent on the question of remedies for breach of contract, it is fair to give the buyer full remedies to effect his expectation interest.<sup>144</sup> However, where the seller has in his forms attempted to limit the buyer's remedy to repair or replacement of the goods,

---

139 See *supra* text accompanying note 125.

140 *Id.*

141 If there is a trade usage or course of dealing, it becomes part of the agreement so that there is no gap to be filled. See U.C.C. § 1-201(3) (1990) ("agreement" includes course of dealing and trade usage); *id.* § 1-205 comment 4 (Code gap-fillers yield to parties' agreement including trade usage).

142 Prelim. Rpt., Part 1, *supra* p. 1018.

143 See *supra* pp. 1019 accompanying notes 57-62.

144 U.C.C. §§ 1-106(1), 2-711 (1990).

that remedy may be reasonable and fair in some circumstances and so should be part of the contract.<sup>145</sup>

[PRELIMINARY REPORT - 2-208]

9. COURSE OF PERFORMANCE OR PRACTICAL  
CONSTRUCTION: 2-208.

*Rec. A2.2 (8).*

*No revisions are recommended in § 2-208(1). The Committee recommends, however, that § 2-208 be moved to Article 1 and integrated with § 1-205. Appropriate revisions of § 2-208(2) & (3) would then be required.<sup>39</sup> See Rec. A.1(6)(A).*

*The "course of performance" principle is important enough to be placed in Article 1 and made applicable to all contracts subject to the UCC. If that is done, a new section on hierarchy, integrating § 1-205(4) and § 2-208(2), and on anti-waiver or anti-modification clauses should be drafted.*

[TASK FORCE - 2-208]

SECTION 2-208

Although no revisions are recommended for this section, the Report suggests that section 2-208 be moved to Article 1 and integrated with section 1-205. A majority of Task Force members believe this is a sound suggestion, as there does not appear to be any need for the confusion which results from separating these two sections. Inevitably, all three forms of extrinsic evidence will overlap when the court invokes the aid of one. The term "contract for sale," which is specifically geared toward Article 2, should be changed to the broader "particular transaction" which will govern the more generalized coverage of Article 1. In addition, section 2-208(2) will have to be integrated into the hierarchy of section 1-205. The opposition on the Task Force to this recommendation is premised on the potential confusion which a renumbering of existing Code sections may cause.

---

145 U.C.C. §§ 2-719(1), 2-207 comment 5 (reasonable remedy limitation clause involves no element of unreasonable surprise).

39. For example, the phrase "contract for sale" in § 2-208(1) should be changed in § 1-205 to a "particular transaction." Also, the hierarchy of controlling terms in § 2-208(2) should be reviewed and integrated with § 1-205(4) and the waiver concepts in § 2-208(3) could be integrated with § 2-209(5).

*[PRELIMINARY REPORT - 2-209]***10. MODIFICATION, RESCISSION AND WAIVER: 2-209.**

*Section 2-209 deals with four related problems: (A) When is an agreed modification of an existing contract enforceable, § 2-209(1); (B) To what extent can the agreement of the parties limit modification or rescission to a signed writing, § 2-209(2); (C) When is a contract as modified within the scope of the statute of frauds, § 2-202(3); and (D) What is a waiver and to what extent can waiver modify the original contract or the contract as modified. Each problem requires separate treatment.<sup>40</sup>*

**1. § 2-209(1).****Rec. A2.2 (9).**

*(A) The Committee recommends that the phrase "good faith" be inserted before the word "agreement" in the text of § 2-209(1).*

*The revision would bring "good faith" to the text from the comments for emphasis. The revision, however, would not define bad faith in this context or clarify the distinction between bad faith and economic duress.<sup>41</sup>*

*(B) Comment 2 should be revised to elaborate this distinction and to illustrate when a modification can be in bad faith but not be made under economic duress.<sup>42</sup>*

**2. § 2-209(2).**

*Unlike the common law,<sup>43</sup> § 2-209(2) permits the parties, with some limitations, to create by a "signed writing" their own statute of frauds for modifications and rescission. Nonconforming agreements, even if made in good faith, will not be enforced.*

---

40. See Murray, *The Modification Mystery: Section 2-209 of the Uniform Commercial Code*, 32 Vill. L. Rev. 1 (1987) for a thorough and critical analysis of these problems.

41. See Hillman, *A Study of UCC Methodology: Contract Modification Under Article 2*, 59 N.C.L. Rev. 335 (1981) (arguing that duress is the tail that wags the modification dog).

42. Economic duress is grounds to avoid a modification when the agreement was induced by a wrongful threat (to breach the contract) coupled with no reasonable market alternative and damages that are uncertain or difficult to prove. A leading case is *Austin Instrument, Inc. v. Loral Corp.*, 29 N.Y.2d 124, 272 N.E.2d 533 (1971). Bad faith, on the other hand, may exist even though there was no threat to breach. See *Roth Steel Products v. Sharon Steel Corp.*, 705 F.2d 134 (6th Cir. 1983). The overlap between the two concepts has created confusion in the courts and stimulated considerable writing. See also, *Restatement, Second*, § 87(1), which appears to adopt a different approach.

43. See Williston, *The Law of Sales in the Proposed UCC*, 63 Harv. L. Rev. 561, 572-76 (1963).

(C) Since no major problems have arisen under § 2-209(2), no revisions are recommended. A majority of the Study Group concluded, however, that an oral modification not in conformity with the parties' "private" statute of frauds should not be enforced even though the exceptions in § 2-201(2) & (3), the "public" statute of frauds, were satisfied.<sup>44</sup> This point could be made in the comments.

The fewer exceptions available under § 2-201, the greater is the need to clarify the effect of a "waiver" by the party for whose benefit the condition was inserted. The relationship between § 2-209(2) and the waiver doctrine, partially exposed in § 2-209(4) & (5), will be treated under Point 4, *infra*.

3. § 2-209(3).

This subsection is unclear and arguably irrelevant. It is unclear because § 2-209(3) fails to say whether the modifying agreement must also be in writing. A preferred interpretation is to treat the "contract as modified" as the only contract to which § 2-209(3) applies.<sup>45</sup> It is irrelevant because it really adds nothing to § 2-201: A modified contract for sale, like the original, must satisfy § 2-201.

(D) The Committee recommends that § 2-209(3) be deleted. This conforms UCC § 2-209 to § 2A-208 of Article 2A.<sup>46</sup>

4. §§ 2-209 (4) & (5).

Sections 2-209(4) & (5) deal with the effect upon contract terms of a waiver. There are two problems here: (1) A comprehensive definition of waiver is not provided; and (2) If the writing requires a signed writing to modify or rescind, § 2-209(2), it is not clear whether the attempted waiver must also satisfy the statute of frauds.

The failure to define waiver has produced confusion. Section 2-209(4) states that an ineffective "attempt" to modify or rescind "can operate as a waiver" and § 2-209(5) provides that a "waiver affecting an executory portion of the contract" can be retracted "unless the retraction would be unjust in view of a material change of position in reliance on the waiver."

---

44. Presumably, this would include any judicial exceptions, such as reliance on the oral promise, as well. But see Murray, *The Modification Mystery* *supra* note 40 at 54.

45. *Id.* at 54-55.

46. The comment to § 2A-208 should be considered for possible adaptation to § 2-209.

*The absence of a definition has generated some interesting judicial decisions<sup>47</sup> and excited the usual amount of law review commentary on exactly what can and what cannot be waived. A working definition of waiver is clearly required.*

*Second, assuming that an oral waiver, through election or reliance has otherwise occurred, it is not clear whether the waiver is effective to discharge a condition that a modification or rescission should be in writing. Clarification of this point is also required.*

*(E) The Committee recommends, at a minimum, that the concept of waiver be defined in the comments. At a maximum, the Committee recommends that a comprehensive definition of waiver be expressed in revised §§ 2-209(4) and (5).<sup>48</sup> This revision should also clarify whether an oral modification can waive the requirements of a "private" statute of frauds.<sup>49</sup>*

[TASK FORCE - 2-209]

## SECTION 2-209

Section 2-209 speaks to related problems: (1) when an agreed modification of an existing contract is enforceable;<sup>146</sup> (2) to what extent an agreement of the parties may limit modification or rescission to a signed writing;<sup>147</sup> (3) when is a contract, as modified,

---

47. *E.g., Wisconsin Knife Works v. National Metal Crafters*, 781 F.2d 1280 (7th Cir. 1986)(attempted oral modification of delivery dates in contract with "private" statute of frauds not a waiver without showing of reliance).

48. At common law, there are two basic types of waiver, "election" waiver and "reliance" waiver. In the former, where an agreed condition has failed (i.e., the modification was oral and not in a signed writing as required by the contract) and the party for whose benefit the condition was agreed elects not to insist upon a writing, the condition is excused. In the latter, where one party states to another "I will not insist upon the stipulated event" and the other relies to his detriment, the executory term is excused. See § 2-209(5)(implicitly endorses a reliance waiver); *Universal Builders, Inc. v. Moon Motor Lodge, Inc.*, 430 Pa. 550, 244 A.2d 10 (1968)(private statute of frauds waived by owner who orders extra work and permits it to be performed without requiring writing).

49. In a proposal not considered by the Study Group, John Murray suggests that §§ (4) and (5) should be deleted and that §§ (2) and (3) should be revised to state that where the contract as modified must be in writing to satisfy the "public" statute of frauds or the "private" statute of frauds created by the "signed agreement" of the parties, either statute of frauds requirement will be met by an appropriate writing or any of the alternative satisfaction devices found in 2-201 as well as the judicially engrafted satisfaction device (with respect to 2-201), i.e., reliance." See Murray, *The Modification Mystery* supra note 40. In effect, this would leave waiver, in general, to the common law and satisfaction of the statute of frauds, public or private, to devices other than waiver.

146 U.C.C. § 2-209(1) (1990).

147 U.C.C. § 2-209(2) (1990).

within the scope of the Statute of Frauds;<sup>148</sup> and (4) to what extent a modification or rescission can operate as a waiver.<sup>149</sup> The Report treats each problem separately.

The Study Group recommends that the phrase "good faith" be inserted before the word "agreement" in the text of section 2-209(1). The term "good faith" presently appears in Comment 2 of section 2-209.<sup>150</sup> This change would thereby create a substantive duty of good faith in modifications. Such a duty technically does not presently exist under the Code because the comments are meant as restatements of the law set out in the Code text and not as independent sources of duties and rights.<sup>151</sup> Because this technical change would not only emphasize the good faith requirement, but would eliminate also any argument about its existence,<sup>152</sup> most Task Force members think that the change should be encouraged.

Economic duress is grounds to avoid a modification when the agreement was induced by a wrongful threat of breach.<sup>153</sup> Economic duress, however, is not necessary to avoid bad faith modification, which may exist even though there was no threat to breach.<sup>154</sup> Because the overlap between these two concepts has caused some confusion in the courts,<sup>155</sup> the Report suggests that the differences between the concepts should be clarified in the comments. This clarification would allow proper claims of bad faith even though economic duress is not present. Most Task Force members agree with this proposal.

If one accepts the reading of section 2-209(3) as treating "the contract as modified" as the only contract to which the section applies,<sup>156</sup> section 2-209(3) arguably is irrelevant since it appears

---

148 U.C.C. § 2-209(3) (1990).

149 U.C.C. § 2-209(4) (1990).

150 The general requirement of good faith in §1-203 imposes the obligation only in the performance and enforcement of contracts. *See* U.C.C. § 1-203 (1990) (imposing an obligation of good faith on each contract or duty's performance or enforcement within this Act).

151 *See* Murray, *The Modification Mystery: Section 2-209 of the Uniform Commercial Code*, 32 VILL. L. REV. 1, 11 n.43 (1987).

152 *Id.*

153 *See, e.g.,* Austin Instruments, Inc. v. Loral Corp., 29 N.Y.2d 124, 130, 272 N.E.2d 533, 535, 324 N.Y.S.2d 22, 25 (1971).

154 *See, e.g.,* Roth Steel Products v. Sharon Steel Corp., 705 F.2d 134, 148 (6th Cir. 1983).

155 *See* Hillman, *A Study of U.C.C. Methodology: Contract Modification Under Article 2*, 59 N.C.L. REV. 335 (1981).

156 This is generally agreed to be the preferred reading. *See, e.g.,* E. FARNSWORTH, *CONTRACTS* 399, § 6.2 n. 23 (2d ed. 1990).



to add nothing to section 2-201.<sup>157</sup> The elimination of this unclear section would also place Article 2 in conformity with the more recent thinking of Article 2A on the issue of modifications.<sup>158</sup> The deletion of this section appears to be sound to the majority of Task Force members. It might, however, also be advisable to clarify in a comment the fact that the contract, with its modifications, is to be treated separately for statute of fraud purposes.

Sections 2-209(4) and (5), dealing with the effect of waiver, raise two problems: (1) there is not a definition of waiver in the Code, and (2) if the writing requires a signed writing to modify or rescind, section 2-209(2) is not clear about whether the attempted waiver must also be in writing. As the absence of a definition of waiver has caused confusion,<sup>159</sup> a definition in the Code, as the Report suggests, is probably needed. In addition, a majority of Task Force members agree that the latter problem also needs to be clarified.

At least one member of the Task Force is of the opinion that section 2-209, in its entirety, should be left unchanged and section 2A-208 should be changed to conform to existing section 2-209(3).<sup>160</sup>

---

157 Although some people believe U.C.C. § 2-209(3) has something to do with validation devices, one commentator has defined its scope in the following manner:

The conventional wisdom concerning the scope of § 2-209(3) recognizes five possibilities: 1) if the original contract is within § 2-201, any modification must be evidence[d] by a writing; 2) a modification must be in writing if the added term brings it within § 2-201 for the first time; 3) a modification must be in writing if the modification, itself, is within § 2-201; 4) a modification changing the quantity term must be in writing; 5) some combination of the foregoing.

Murray, *The Modification Mystery: Section 2-209 of the Uniform Commercial Code*, 32 VILL. L. REV. 1, 21 (1987).

158 U.C.C. § 2A-208 (1990).

159 See, e.g., *Wisconsin Knife Works v. National Metal Crafters* 781 F.2d 1280, 1286-87 (7th Cir. 1986) (discussing whether an attempted modification acts as a waiver).

160 See generally Roszkowski, *Contract Modification and the Statute of Frauds: Making Sense of Section 2-209 of the Uniform Commercial Code*, 36 ALA. L. REV. 51 (1984) (stating that a literal reading of U.C.C. § 2-209(3) can resolve any confusion surrounding the purpose and operation of § 2-209).

*[PRELIMINARY REPORT - 2-210]***11. DELEGATION OF PERFORMANCE; ASSIGNMENT OF RIGHTS: § 2-210.**

*No revisions are recommended in § 2-210.*

*The principles in § 2-210, which are consistent with those in Chapter 15 of the Restatement, Second, of Contracts, have produced no major problems of practical importance in sales transactions.<sup>50</sup> In fact, § 2-210 has facilitated the assignment by an immediate buyer to a second purchaser of warranties made and breached by his seller, thereby permitting the second purchaser to sue the seller without privity of contract.<sup>51</sup>*

**[TASK FORCE - NONE]**

*[PRELIMINARY REPORT - 2-301]*

**ARTICLE 2, PART 3:  
GENERAL OBLIGATION AND CONSTRUCTION OF  
CONTRACT**

**A. OVERVIEW.**

*Article 2, Part 3 deals with the "general obligation and construction" of the contract for sale. Sections 2-301 through 2-311 cover, inter alia, the "gap" filler terms, §§ 2-312 to 2-318 deal with warranties and §§ 2-319 to 2-328 cover delivery terms, consignment problems and sales by auction.*

**B. GENERAL OBLIGATIONS OF PARTIES: § 2-301.**

*No revisions in § 2-301 are recommended.*

**C. UNCONSCIONABLE CONTRACT OR CLAUSE: § 2-302.**

*Rec. A2.3 (1).*

*(A) No revisions in the Text of § 2-302 are recommended.<sup>1</sup> The Comments, however, should be revised to clarify, among other*

---

50. See §§ 9-206 & 9-318 for the principles in secured transactions. But see Comment, § 2A-303, where the provisions of § 2-201 were incorporated "with substantial modifications to reflect leasing terminology and practice, as well as certain developments of the law with respect to creditor's rights." These modifications should be evaluated before a final decision on § 2-210 is reached. See, generally, Harris, *The Rights of Creditors Under Article 2A*, 39 Ala. L. Rev. 803 (1988).

51. See, e.g., *Collins Co., Ltd. v. Carboline Co.*, 125 Ill.2d 498, 532 N.E.2d 834 (1988)(express warranties).

1. But see § 2A-108, which includes the scope of and expands the remedies for unconscionable conduct in consumer leases.

*things, the scope and content of the standard. The Drafting Committee should also consider whether to move § 2-302 from Article 2 to Article 1, where it clearly would be applicable to all of the UCC. A majority of the Study Group favor this action.*

*Innovative when first proposed, the principle of § 2-302 has now become part of general contract law. See Restatement, Second, Contracts § 2-208. Controversial at first, the principle has become more accepted as legislatures embrace it in consumer protection legislation and as courts have shown restraint in application, particularly in commercial disputes. In short, it has become a limited device for increased protection against abuse in the bargaining process—protection that extends the concepts of fraud and duress but stops short of rewriting the substantive terms of the contract.<sup>2</sup> These developments support both the retention and the movement to Article 1 of § 2-302.*

*The comments to § 2-302, however, should be substantially revised. The revision should consider, among other things, the following problems:*

*1. If § 2-302 is primarily a device to remedy procedural unfairness, what factors are relevant to that inquiry? For example, if a contracting party has adequate information about the content of a writing but had limited choice, can the contract or clause be declared unconscionable?*

*2. Should the unconscionability principle be limited to the time of contracting, or can the court also consider unconscionable inducement and the unconscionable effect of enforcing a contract which was conscionable when made?<sup>3</sup>*

*3. To what extent should § 2-302 provide a residual principle which is available even though more specific tests of procedural fairness, found in other sections of Article 2, have been satisfied? For example, if a disclaimer of implied warranties satisfies the conditions imposed by § 2-316(2) yet the relative bargaining power of the parties is called into question, should § 2-302 be invoked to review the contract?<sup>4</sup>*

**(B) A majority of the Study Committee support '§ 2-302 as a residual principle. Even though there is no "unfair surprise" under**

---

2. There is a fine line between a substantive provision that is *per se* against public policy (e.g., a confession of judgment clause in some states) and a provision which is simply one-sided (e.g., an "add on" clause). The "proceduralists" would enforce the one-sided clause without inquiry into its commercial purpose if the contracting party had adequate information and choice.

3. Arguably, recognizing unconscionable inducement and effects is a change that should be made in the statute.

4. For an affirmative answer, see *Martin v. Joseph Harris Co., Inc.*, 767 F.2d 296 (6th Cir. 1985)(under Michigan law, commercial buyer had no realistic choice).

§ 2-316(2), the one-sided clause may have been imposed upon a party with no "meaningful choice."

(4) Should § 2-302 be revised to reflect the distinction between consumer and commercial contracts? Despite the precedent of § 2A-108, a majority of the Study Group have concluded no.

**D. ALLOCATION OR DIVISION OF RISKS: § 2-303.**

*No revisions are recommended in § 2-303.*

**E. PRICE PAYABLE IN MONEY, GOODS, REALTY, OR OTHERWISE: § 2-304.**

**Rec. A2.3 (2).**

*No revisions are recommended in the text of § 2-304. Remedial problems created when the price is made payable in a foreign currency, however, should be considered.*

*A sale "consists in the passing of title from the seller to the buyer for a price. . .," § 2-106(1), and the buyer's "obligation. . . is to accept and pay in accordance with the contract." § 2-301. Section 2-304(1) prescribes (1) in what the price may be paid, i.e., "money or otherwise," and (2) the consequences of agreeing that the price is payable in goods or an interest in realty. § 2-304(1). There is virtually no litigation under this section.*

*A problem exists, however, where a seller and buyer stipulate that, because of the stability of its purchasing power, the price shall be paid in the "money" of another country. If the buyer fails to pay and the litigation occurs in American courts, the foreign currency will be converted into U.S. dollars on either the day of the breach or the day of the judgment. If there is a long delay in payment and dollars are less stable than the foreign currency, the seller suffers a loss. Leary & Frisch argue that there is "no reason why a commercial code should not permit parties to specify the currency that they desire to use as the 'store of value' for their transactions."<sup>5</sup> If so, then perhaps § 2-304 is the place where that authorization should be made.<sup>6</sup>*

**F. OPEN PRICE TERM: § 2-305.**

*No revisions are recommended in § 2-305.*

*The contract price, when agreed to by the parties, allocates the risk of subsequent changes in the market that affect either the seller's cost of production*

---

5. Revision at 456.

6. These problems are fully treated in the Uniform Foreign-Money Claims Act, drafted by the NCCUSL and approved and recommended for enactment in all the states. The statute has been enacted in Utah.

or the market value of the goods. Section 2-305, however, deals with the case where the parties or some stipulated external person or standard have failed to agree on or fix the price.<sup>7</sup> In these cases, the issues are as follows:

1. Did the parties "intend. . . to conclude a contract even though the price is not settled?" This is a particularized application of the general principle in § 2-204(3) and will depend upon the facts and circumstances. If they did not, § 2-305(4) states that there is "no contract" and requires restitution by both parties.<sup>8</sup>

No problems of substance have arisen here.

2. If the parties did intend to conclude a contract, § 2-305(1) provides the "gap" filler if certain circumstances exist: "In such a case the price is a reasonable price at the time for delivery. . . ." An important question is whether a "reasonable price" can be proved. If not, the contract may fail for indefiniteness. § 2-204(3).

Although uncertainty may be created by the complexity of the proof, no problems of substance have arisen under this standard.

3. What is the relevance of the duty of good faith under § 2-305?

Under § 2-305(2), if the agreement provides that the price is to be fixed by either the seller or the buyer, it "means a price for him to fix in good faith."<sup>9</sup> If the party is a merchant, the objective standard of good faith in § 2-103(1)(b) is applicable. There has been some interesting litigation on this issue,<sup>10</sup> but no problems different from those associated with the general application of the good faith duty have arisen.

4. A more interesting question involves an agreement between the parties to agree on the price. Assuming an intent to conclude a contract, the agreement to agree is, presumably, impressed with a duty to negotiate in good faith. Otherwise, the bargain would be illusory. If they fail to agree in good faith, the contract price is a "reasonable price. . . ." § 2-305(1)(b). But suppose that there is no agreement because one party negotiated in bad faith. Is the other party limited to the same gap filler or are other remedies available? Does the "agreement to agree" approach apply to other terms of the agreement?

---

7. The pre-Code law is reviewed in Prosser, *Open Price in Contracts For the Sale of Goods*, 16 Minn. L. Rev. 733 (1932).

8. These issues are explored in *In Re Glover Construction Co., Inc.*, 49 Bankr. 581 (Bankr. W.D. Ky. 1985).

9. Cf. § 2-305(3), where one party is given the option to fix a "reasonable price" if the other's fault has prevented the fixing of the price "otherwise than by agreement of the parties."

10. E.g., *Au Rustproofing Center, Inc. v. Gulf Oil Corp.*, 755 F.2d 1231 (6th Cir. 1985)(seller's exercise of discretion not in bad faith).

*The answers to these questions are not clear from the current text of Article 2. Whether they need to be answered at this time is another question.<sup>11</sup>*

**G. OUTPUT, REQUIREMENTS AND EXCLUSIVE DEALINGS: § 2-306.**

**Rec. A2.3 (3).**

*No revisions are recommended in the text of § 2-306. The Comments, however, should be revised to clarify several points and to encourage the parties to draft agreements more carefully.*

1. "Output" and "requirements" terms both satisfy the statute of frauds, § 2-201(1), and provide flexibility in case of changing supply and demand. The duty of good faith imposes some control over discretion, as does the not "unreasonably disproportionate" limitation in § 2-306(1). Some courts, however, have concluded that the parties must also have an exclusive dealing arrangement for output and requirements contracts to be enforceable. Compare § 2-306(2).<sup>12</sup>

*(A) This requirement of exclusive dealing is incorrect and should be expressly disavowed in revised comments.*

2. The question, what is "bad faith," is sometimes litigated under § 2-306(1). Either one party has ordered too much or produced too little or had no actual output or requirements, allegedly in bad faith.<sup>13</sup> Similarly, disputes over the meaning of "best efforts" in exclusive dealing relationships sometime arise. § 2-306(2).<sup>14</sup> These disputes result, in part, from open-

11. Arguably, Article 2 stops one step short of developing a perceptive duty to bargain in good faith, whether before the contract is performed or during performance or when a modification is proposed. See Bermingham, *Extending Good Faith: Does the UCC Impose a Duty of Good Faith Negotiation Under Changed Circumstances?*, 61 St. John's L. Rev. 217 (1987)(concluding "no"). As result, there is uncertainty about when the duty applies and, of course, what is bad faith bargaining. See, generally, Farnsworth, *Pre-Contractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 Colum. L. Rev. 217 (1987). See Rec. A1 (5).

12. This requirement is effectively criticized in Bruckel, *Consideration in Exclusive and Nonexclusive Open Quantity Contracts Under the U.C.C.: A Proposal for a New System of Validation*, 68 Minn. L. Rev. 117 (1983).

13. A leading case is *Orange & Rockland v. Amerada Hess Corp.*, 59 A.D. 110, 397 N.Y.S.2d 814 (1977)(buyer fixed requirements in bad faith). See Comment, *Requirements Contracts, "More or Less," Under the Uniform Commercial Code*, 33 Rutgers L. Rev. 105 (1980).

14. A leading case is *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979), analyzed in Goetz & Scott, *Principles of Relational Contracts*, 67 Va. L. Rev. 1089 (1981).

ended standards that must be particularized in each case and from the lack of clear objectives to be achieved in the search for bad faith.<sup>15</sup>

**(B) The Study Group recommends that an effort be made to better define these concepts in the comments.**

3. A final issue is the relationship between the duty of good faith and the "unreasonably disproportionate" limitation. The former limits behavior at the time of actual output or requirements and the latter is concerned with stated estimates at the time of contracting or prior patterns of quantity.<sup>16</sup> The particular question is whether a seller who in good faith has no output and a buyer who in good faith has no requirements may tender or demand no goods at all. Most commentators and at least one case<sup>17</sup> have concluded yes, but this result is not clear from either the statute or the comments.

**(C) We recommend that this conclusion (i.e., a good faith tender or demand for no quantity is not unreasonably disproportionate) be made clear in either the text or comments of § 2-306(1).**

#### **H. DELIVERY IN SINGLE LOT OR SEVERAL LOTS: § 2-307.**

**No revisions are recommended in the text of § 2-307.**

Section 2-307 applies when the parties have not agreed upon delivery in installments. See § 2-612(1). The "single delivery" gap filler appears to be sensible and flexibility is provided by the "circumstances" exception. There has been no litigation of importance under § 2-307.<sup>18</sup>

#### **I. ABSENCE OF SPECIFIED PLACE FOR DELIVERY: § 2-308.**

**No revisions are recommended in the text of § 2-308.**

§ 2-308 determines the place for delivery "unless otherwise agreed." The manner of the seller's tender of delivery at that place is then set forth in §§ 2-503 & 2-504.

---

15. An apparent objective is to minimize "opportunistic" behavior by one party to the contract. See, e.g., Muris, *Opportunistic Behavior and the Law of Contracts*, 65 Minn. L. Rev. 521, 556-65 (1981); Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, 381-84, 395-97 (1980)15.

16. Again, one of the best judicial opinions on what is "unreasonably disproportionate" is *Orange & Rockland*, *supra* note 13.

17. *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988)(Posner, J.); Comment, *And Then There Were None: Requirements Contracts and the Buyer Who Does Not Buy*, 64 Wash. L. Rev. 871 (1989).

18. Peters found a tension between the presumption in § 2-612(1) that an installment contract was intended when the goods were "separately accepted" and the policy favoring a unitary contract in § 2-307. She concluded that the tension could be resolved by making it clear that the time of delivery and payment need not be the same to have an installment contract. See *Roadmap* at 223-24.

*One might question whether the "seller's place of business" is a sensible default rule in transactions where the parties are at a distance and shipment of the goods is normal. Perhaps the parties will use the "fob" terms or a trade usage supporting shipment will become part of the agreement. Absent an "fob" term or trade usage, however, it may not be enough that another place for delivery is "common" in the trade.<sup>19</sup>*

**J. ABSENCE OF SPECIFIC TIME PROVISIONS; NOTICE OF TERMINATION: § 2-309.**

**Rec. A2.3 (4).**

*Two revisions, as noted below, are recommended in the text or comments of § 2-309.*

**1. Performance issues.**

*Section 2-309(1) provides that the "time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time." No revision is recommended in the "reasonable time" standard, as elaborated in Comments 1 and 3-6. See § 1-204.*

*Section 2-309(1), however, does not mention the time when payment is due. Other Article 2 provisions must be consulted. See Comment 2. Unless otherwise agreed, payment is due "at the time and place at which the buyer is to receive the goods. . . ." § 2-310(a). Even so, payment is still not due until the seller has tendered the goods, § 2-507(1), and the buyer has had a reasonable opportunity to inspect them. §§ 2-310(b) & 2-513(1). At that point, a failure timely to reject is an acceptance, § 2-606(1)(b), and obligates the buyer to pay the price. § 2-607(1). See § 2-709(1)(a), which permits the seller to recover the price of accepted goods when the "buyer fails to pay the price as it becomes due. . . ."*

*(A) The Drafting Committee should clarify when the price is due in the text of § 2-309(1) or in the comments. The current cross references are incomplete and Comment 2 is confusing.*

**2. Termination issues.<sup>20</sup>**

*§§ 2-309(2) and (3) deal primarily with the following transaction. Seller and Buyer agree to "successive performances" under a distributorship relationship but the contract is "indefinite in duration." In this situation,*

---

<sup>19.</sup> See *Dura-Wood Treating Co. v. Century Forest Industries, Inc.*, 675 F.2d 745 (5th Cir. 1982).

<sup>20.</sup> See § 2-106(3).



*"unless otherwise agreed," the contract is "valid for a reasonable time." After a reasonable time has expired, the contract "may be terminated at any time by either party" but "termination of a contract by one party. . . requires that reasonable notification be received by the other party. . . ." Thus, the contract is enforceable for a reasonable time but either party, by giving reasonable notice,<sup>21</sup> may terminate it thereafter. No revisions are recommended in this statutory language.*

*A question not fully answered by § 2-309 is the extent to which the parties may contract out of the limitations of subsections (2) and (3). Notice is not required if the contract provides for termination "on the happening of an agreed event." § 2-309(3). Presumably, this is an external event (i.e., if the Cubs win) beyond the control of both parties. On the other hand, an "agreement dispensing with notification is invalid if its operation would be unconscionable." § 2-309(3). Presumably, this deters a termination that deprives the other of time to seek a substitute arrangement or to preserve assets. But what about a common provision (in franchise agreements) that gives one or both parties power to terminate for any reason upon giving 60 days notice? Is this power subject to the duty of good faith?*

*(B) A majority of the Study Group think that the duty of good faith should apply<sup>22</sup> and recommend that the Drafting Committee make this clear in either the text or comments. A minority believe that the comments to § 2-309 already impose adequate restrictions upon terminations in these cases.<sup>23</sup>*

#### **K. OPEN TIME FOR PAYMENT OR RUNNING OF CREDIT; AUTHORITY TO SHIP UNDER RESERVATION: § 2-310.**

##### **Rec. A2.3 (5).**

*No revisions are recommended in the text of § 2-310. The Drafting Committee should consider whether the different subsections of § 2-310 can be better integrated with other relevant sections of Article 2, Part 5.*

*There is no litigation of significance under § 2-310 and no problems of importance are apparent.*

---

21. See *Teitelbaum v. Hallmark Cards, Inc.*, 520 N.E.2d 1333 (Mass. App. 1988)(exploring when the notice of termination is reasonable).

22. An agreed termination is "performance" of the contract under § 1-203.

23. For an case which imposed the duty of good faith but held that bad faith was not proved, see *Zapatha v. Dairy Mart, Inc.*, 381 Mass. 284, 408 N.E.2d 1370 (1980). The Drafting Committee may wish to consider the position taken in the Uniform Franchise and Business Opportunities Act.

*The question remains whether the comments and cross references adequately mesh § 2-310 with other sections (most of which are in Part 5) essential to its sound operation. If there is doubt, one solution is to redraft § 2-309(1) to include material on the time when payment is due, move § 2-310 to Part 5 and revise and integrate the remaining payment problems into an functional whole.*

**L. OPTIONS AND COOPERATION RESPECTING PERFORMANCE: § 2-311.**

*No revisions are recommended in the text of § 2-311.*

*There are no cases of importance interpreting § 2-311. The principle stated in § 2-311(1) is sound. See § 2-305(2). The balance of § 2-311 deals with who is responsible for what specification, § 2-311(2), and what happens when a specification is "not seasonably made." § 2-311(3).*

**M. WARRANTY OF TITLE AND AGAINST INFRINGEMENT; BUYER'S OBLIGATION AGAINST INFRINGEMENT: § 2-312.**

*No revisions are recommended in the text of § 2-312 at this time.*

*The Study Group did not have an opportunity fully to study the operation of § 2-312. A number of obvious problems, however, have arisen: (1) What is a sufficient "cloud" on title to breach the warranty; (2) Who makes a warranty of title in auctions and sheriff's sales; (3) Does § 2-312(1) adequately account for the development of trade practice; and (4) Should the disclaimer provision in § 2-312(2) be moved to § 2-316? See § 2A-214.*

*These and other problems should be treated before the Final Report is submitted.*

**N. WARRANTIES OF QUALITY: OVERVIEW**

**1. Relevant Article 2 Provisions.**

*There are several sections of Article 2 that determine whether a seller has made and breached a warranty of quality and, if so, the buyer's remedies. These sections assume that warranties, express or implied, are terms of the contract between the parties. They make no effort to distinguish between commercial and consumer buyers and, with two exceptions, see § 2-715(2)(b) and § 2-719(3), assume that the damages for breach of warranty will involve economic loss rather than damage to person or property.*

*A first group, §§ 2-313 through 2-318, deals with the creation of warranties, express or implied, attempts to disclaim or limit warranties, conflicts between warranties and the extension of warranties beyond the immediate seller.*

*A second group involves remedies for breach of warranty and will be analyzed in Parts 6 and 7. If the goods do not conform to a warranty, the buyer may, before acceptance, § 2-606, reject the goods, §§ 2-601 through 2-605, and pursue available buyer's remedies under § 2-711(1). The same remedies are available if the buyer, after acceptance, is able to revoke acceptance under § 2-608. If the buyer is unable to revoke an acceptance, however, the remedial options are narrowed. The buyer is liable for the price, cannot reject the goods, must give the seller notice of and has the burden to establish breach. See § 2-607. Moreover, the buyer's direct damages are measured under § 2-714 and incidental and consequential damages are measured under § 2-715. Under controlled conditions, however, damages for breach can be liquidated, § 2-718(1), or limited, § 2-719, by agreement between the parties.*

*Finally, the time when the statute of limitations begins to run on a claim for breach of warranty is determined by § 2-725.*

## *2. Consumer Protection.*

*Where consumer buyers are concerned, Article 2 occupies an uneasy position between federal law, e.g., the Magnuson-Moss Warranty Act and the fast developing state lemon and other laws.<sup>24</sup> Consumer and non-consumer buyers are treated the same under Article 2. This may be an unsatisfactory position, because gaps in protection between federal and other state law exist to which Article 2 does not respond.<sup>25</sup>*

### *Rec. A2.3 (6).*

*To date, the Study Group has limited its effort to a review of existing provisions of Article 2 rather than recommending a increase in warranty protection for consumers. We suggest, however, that the Drafting Committee identify the gaps in protection between federal and non-uniform state law that are not covered by Article 2 for possible inclusion in a Comment.<sup>26</sup> A majority of the Study Group*

---

<sup>24</sup> See Revision at 410-14, 442-43.

<sup>25</sup> See Rice, *Product Quality Laws and the Economics of Federalism*, 65 B.U. L. Rev. 1 (1985).

<sup>26</sup> The areas where potential gaps may occur include: (1) The definition of "consumer" and consumer goods; (2) The scope of any definition of warranty; (3) The extent to which the seller may disclaim implied warranties or limit remedies for breach; (4) The

*concluded that, despite any gaps, further development of consumer protection within Article 2 was not justified.*<sup>27</sup>

### 3. Relationship to Tort.

*Personal injuries and property damage. When a buyer is injured in person or suffers property damage resulting from nonconformities or defects in goods, a claim in tort (usually strict liability) may be available against the seller. In most states, the buyer is free to pursue the advantages of tort without the limitations of contract found in Article 2. In tort, lack of privity is no defense, there are no notice requirements, it is more difficult to exculpate oneself from liability and the statute of limitations runs from the time the defect was or should have been discovered rather than from the time of tender.*<sup>28</sup>

#### *Rec. A2.3 (7).*

*Subject to the terms of any Product Liability Legislation, the Study Group recommends that the freedom of a buyer to sue in tort even though the claim could be pursued under Article 2 be preserved.*

*What if the buyer decides to pursue the personal injury or property damage claim in warranty as well as tort? Article 2 contemplates this possibility, see §§ 2-715(2)(b) & 2-719(3), but does not elaborate the standards to be applied.*

#### *Rec. A2.3 (8).*

*The Study Group recommends that this option be preserved. But the buyer who pursues a warranty claim involving personal injury or property damage should be subject to the same limitations under Article 2 as a buyer who has suffered only economic loss. We recommend, therefore, that this parity be achieved by eliminating any special rules, such as § 2-719(3) and § 2-318, based upon personal injury and property damage.*

*4. Economic loss. In recent years, buyers of nonconforming goods which caused only economic loss<sup>29</sup> have brought suit in tort to escape limitations*

---

*extent to which a buyer can obtain a full refund or replacement of defective goods upon the seller's failure to repair; (5) The extent to which lack of privity is a defense in suits between a consumer buyer and the manufacturer; and (6) The extent to which remedies for breach of warranty include attorney's fees or punitive damages. See C. Reitz, *Consumer Product Warranties Under Federal and State Laws* (2d ed. 1987).*

*27. The National Conference of State Legislatures has under development a model "Lemon Law" that, if it replaces the non-uniform acts passed in some 46 states, may well fill one such gap.*

*28. See Revision at 416-19; Wade, *Tort Liability for Products Causing Physical Injury and Article 2 of the U.C.G.*, 48 Mo. L. Rev. 1 (1983).*

*29. "Economic loss" is a shorthand for contract interests, whether they be expectation, reliance or restitution. In most cases, the losses will involve the buyer's direct and consequential loss from the agreed bargain.*

in Article 2, such as the privity requirement and the statute of limitations. Frequently, either the nonconformity or the nature of the accident created a risk to person or property, although the actual loss was solely economic. Sometimes the defect will cause damage to the goods sold beyond the difference in value between the goods as warranted and the goods delivered.<sup>30</sup>

In commercial cases, most courts have rejected the great tort escape where the damage is solely economic. Although the reasons vary, a recurring concern is that tort would undercut Article 2 and its contractual scheme of risk allocation.<sup>31</sup> The courts, however, have disagreed on the result when the defect causes damage to the goods sold and some decisions have permitted an action in tort.<sup>32</sup>

**Rec. A2.3 (9).**

*The Study Group endorses the limitation upon access to tort in cases of pure economic loss, but believes it is beyond our scope to place a limitation in Article 2. In these cases where everyone has a contract with someone in the distributive chain and the losses involve contract interests, Article 2 is the appropriate source of law. The Study Group makes no recommendation where the loss also includes damage to the goods sold. Rather, this problem is left to the courts for decision on a case by case basis.*

## ARTICLE 2 - PART 3

### [TASK FORCE - WARRANTIES - GENERAL]

#### *Relationship of Warranty Transactions to Tort*

Several Study Group recommendations address concerns regarding the overlap between sales warranty and tort law. This

---

30. E.g., S sells a generator to B for \$1,000,000 containing a defective rotor blade which can be replaced for \$10,000. The blade breaks in operation, causing \$250,000 consequential damage to the generator but no damage to the person or other property of B.

31. A leading case is *Spring Motors Distributors, Inc. v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985) which, after discussing the relevant cases, held that a buyer who had suffered only economic loss from an unmerchantable product could not sue in tort to avoid the statute of limitations in Article 2. The point is not emphasized, however, in cases involving personal injury and property damages, which Article 2 also covers. The issues are well analyzed in Schwartz, *Economic Loss in American Tort Law: The Examples of J'Aire and of Products Liability*, 23 San Diego L. Rev. 37, 51-78 (1986).

32. See, e.g., *American Home Assurance Co. v. Major Tool & Mach.*, 767 F.2d 445 (8th Cir. 1985)(Minnesota law); *Mid Continent Aircraft Corp. v. Curry County Spraying Service*, 572 S.W.2d 308, 312-13 (Tex. 1978)(defect which harms only the product is not part of the larger accident problem which tort law addresses).

overlap is evidenced by cases in which tort recoveries are awarded for solely economic loss while circumventing traditional warranty law limitations such as privity, notice and statute of limitations.

Rec. A2.3(7) unexceptionally recommends that, in cases of personal injury and property damage resulting from nonconformities or defects in the goods, the buyer should retain the freedom to sue either in tort or under Article 2. However, the Study Group also recommends that a personally injured-property damaged buyer who proceeds under Article 2 should be subject to the same Article 2 limitations as a buyer who is asserting a claim only for economic loss. The Study Group would achieve such "parity" by eliminating special rules "such as § 2-719(3) and § 2-318, based upon personal injury and property damage."<sup>161</sup>

The two referenced sections, of course, provide respectively that "[l]imitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable" and that warranties made to a buyer also extend to certain third party beneficiaries.<sup>162</sup>

The Study Group discussion of these recommendations discloses little more than an objective of parity between warranty law and tort law. The later discussion of section 2-318 is more illuminating:

---

161 Prelim. Rpt., Part 3, Rec. A2.3(8), *supra* p. 1083.

162 U.C.C. §§ 2-719(3), 2-318 (1990). Section 2-318 presently offers three alternatives defining who falls within the protected class. What is now denominated "Alternative A" was originally the sole Official provision in the 1962 text. However, as states began to adopt the Code, the provision came under attack. For example, by 1964, it had been criticized in California as "a step backward" and omitted. It was extended in Wyoming in the language now subsumed as official Alternative B, and extended in Virginia to wholly dispense with both horizontal and vertical privity and any requirement of personal injury. At that time, the Permanent Editorial Board continued to maintain that "beyond the limits of the present section the subject is still highly controversial, and there appears to be no national consensus as to the scope of warranty protection which is proper. Accordingly, no amendment should be made to the Official Text." Report No. 2, Permanent Editorial Board for the Uniform Commercial Code 39-40.

In 1966, the Permanent Editorial Board acknowledged the futility of its position and recommended the addition of the increasingly liberal Alternatives B and C to reflect evolving case law and § 402A of the Restatement (Second) of Torts. Report No. 3, Permanent Editorial Board for the Uniform Commercial Code 14 (1967).

Debates about the interpretation of § 2-318 often overlook the fact that a number of states adopted the Code before the alternatives were officially promulgated.

The current § 2-318, with its three alternatives, is an anachronism. It was drafted before strict tort liability developed in addition to warranty theory where damage to person or property resulted. Furthermore, the stated basis for extension, "third party beneficiaries," is a fiction.<sup>163</sup>

Although it is clearly the case that the Article 2 provisions were drafted before strict liability in tort matured, it is not clear that the basis for extension was "third party beneficiaries." Presumably, the Study Group plucked that reason from the title of the section. However, it would have been more appropriate to look to Comment 2 in which it is stated that the section "rests primarily upon the merchant-seller's warranty under this Article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used."<sup>164</sup>

Although it is certainly true that safety as a characteristic of merchantability does not necessarily encompass breaching classic barriers of privity, the case law at the time of the drafting of the Code was clearly developing along those lines. Thus, it may have been the case that the Code draftsmen chose language designed to expand liability in "conservative" privity jurisdictions while not interfering with rapidly evolving developments in the more "progressive" jurisdictions. Perhaps they also intended to obviate the need to resort to clumsy analyses, like agency, to achieve justice.<sup>165</sup> More to the point is consideration of the possible impact of the Study Group recommendations. First of all, the recommendation speaks to doing away with the "special rules, *such as* § 2-719 and § 2-318."<sup>166</sup> Are there others than those cited? Presumably, Official Comment 5 to section 2-607 (suggesting notice requirements are different for non-buyer plaintiffs) would have to go since it refers in substance to section 2-318.

At the very least, if such a course were taken, comments should emphasize that any change was not intended to affect tort law. Indeed, it may be that a study should be conducted to determine the extent to which current case law has been affected by the existence of the section. Any jurisdiction in which lines have

---

163 Prelim. Rpt., Part 3, *infra* p. 1112-13.

164 U.C.C. § 2-318 comment 2 (1990).

165 *See, e.g.*, 1 NEW YORK LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE 412-15 (1955) (Professor Honnold commenting).

166 Prelim. Rpt., Part 3, Rec. A2.3(8), *supra* p. 1083.

been drawn in relation to those in section 2-318 would be put in a very peculiar position by such a change.

It is tempting, even comforting, to simply say that tort law is designed to deal with the special problems of personal injury and is more properly shaped by considerations of public policy. But that overlooks the whole history of sales law,<sup>167</sup> as one significant prong of sales warranty law is public policy. That was the basis of the development of the implied warranty of merchantability; it was also the basis of that part of sales warranty law dealing with personal injury problems that eventually became Strict Liability in Tort. It does not follow that because there has been an explosion in tort theory, there should be a withdrawal in sales law. Moreover, the Study Group recommendations would remove from Article 2 the only provisions which make specific reference to consumers. Such a retraction should be made for more than aesthetic reasons.

It is also the case that the federal Magnuson-Moss Act, applicable to cases involving consumer goods, provides standing for a number of plaintiffs other than technical buyers.<sup>168</sup> This broader standing is not confined to cases of personal injury and sometimes may not even be available in cases of personal injury.<sup>169</sup> However, the broader standing in the act again gives rise to the issue of whether a revised Article 2 can ignore law controlling consumer goods transactions.<sup>170</sup>

The Study Group's recommendation assumes that it is always easier to assert a strict liability claim in tort than a warranty claim (there is reference to the "great tort escape").<sup>171</sup> Although that is often true, it sometimes may be easier to show that there was a breach of warranty which caused injury than to show that the injury was caused by a defect which made the product "unrea-

---

167 See *infra* notes 181-204 and accompanying text (discussing brief history of sales law).

168 15 U.S.C. § 2310 (1988).

169 In fact, the cases have been unusually antagonistic to attempts to use the Magnuson-Moss Act in cases involving personal injury claims unless the case also involves a violation of one of the provisions of the Act. See NATIONAL CONSUMER LAW CENTER, SALES OF GOODS AND SERVICES § 33.7.7.2 n.289 (2d ed. 1989). Although Professor Reitz is uneasy with many of the arguments made in the cases, he finds solace in the availability of strict liability in tort which should be easier to prove anyway. C. REITZ, CONSUMER PRODUCT WARRANTIES UNDER FEDERAL AND STATE LAWS 146-47 (2d ed. 1987).

170 See *supra* pp. 1000-09 accompanying notes 15-47.

171 Prelim. Rpt., Part 3, *supra* p. 1083.



sonably dangerous." Should a plaintiff be deprived of that opportunity?

The final Study Group recommendation relating to tort law, Rec. A2.3(9), is an expression of belief as to what tort law should be regarding cases involving pure economic loss. Although the language of discussion is not entirely clear, it appears the Study Group favors the line of tort cases which holds that sales warranty law, and not tort law, should apply to cases in which there is only pure economic loss (and in which the defect does not cause damage to the goods or other property). The Group expressly "makes no recommendation where the loss also includes damage to the goods sold."<sup>172</sup> Appropriately, the Group concedes that it is beyond their scope to place such a limitation in Article 2.

*[PRELIMINARY REPORT - 2-313]*

*O. EXPRESS WARRANTIES BY AFFIRMATION, PROMISE, DESCRIPTION, SAMPLE: § 2-313.*

*Section 2-313 distinguishes between affirmations, promises, samples and descriptions which can create express warranties, § 2-313(1), and affirmations, statements, or commendations which cannot, § 2-313(2). Section 2-313(1) then states that promises and representations which can become express warranties must also become or be made "part of the basis of the bargain." Neither § 2-313(1) nor § 2-313(2) provide a test for the distinctions that must be made. Comments 3 and 8, however, suggest a common strategic approach: All statements made, whether ultimately classified as those governed by § 2-313(1) or (2), are presumed to be part of the basis of the bargain unless taken out by "clear affirmative proof" or for "good reason. . . shown to the contrary." The implication is that once the buyer proves that the statements were made, the seller must prove a negative, i.e., that they were not part of the basis of the bargain. The best evidence of the negative might be that the buyer did not in fact believe or was unreasonable in believing that the statement was part of the bargain.<sup>33</sup>*

*The Study Committee disagreed on what the test should be. The disagreement ranged between a suggestion that the buyer must prove reasonable*

---

<sup>172</sup> Prelim. Rpt., Part 3, Rec. A2.3(9), *supra* p. 1084.

<sup>33</sup> See *Special Project, Article Two Warranties in Commercial Transactions*, 64 *Cornell L. Rev.* 30, 59-61 (1978). The warranty project was updated in 1987. See *Update*, 72 *Cornell L. Rev.* 1159 (1987).

reliance on the affirmation (a return to the USA test)<sup>34</sup> to a proposal that "basis of the bargain" be replaced by a "reasonable expectations" test that applied both before and after the contract was made.<sup>35</sup> In the middle, some supported the "presumption" test stated in the comments and, with clarifications, were content to leave the matter for the courts. This disagreement mirrors to some extent the range of views found among the courts and commentators.

*Rec. A2.3 (10).*

*The Study Group urges the Drafting Committee to resolve the debate over this important issue without returning to an explicit reliance test. More particularly, the solution should (1) Incorporate the "presumption" test, now stated in the comments, into the text of § 2-313; (2) Clarify whether the affirmations governed by § 2-313(2) are part of the "presumption" test; and (3) Elaborate when a promise or representation made after contract formation becomes part of the bargain.*

[TASK FORCE - 2-313]

SECTION 2-313

1. *Basis of the Bargain.*

The focus of the Study Group's two page discussion of express warranty was "part of the basis of the bargain."<sup>173</sup> We are told that:

The Study Committee disagreed on what the test should be. The disagreement ranged between a suggestion that the buyer must prove reasonable reliance on the affirmation (a return to the USA test) to a proposal that "basis of the bargain" be replaced by a "reasonable expectations" test that applied both before and after the

---

34. For a case approaching this position, see *Royal Business Machines, Inc. v. Lorraine Corp.*, 633 F.2d 34, 41-45 (7th Cir. 1980) ("basis of the bargain" is, in essence, a reliance test). Cf. *Restatement, Second, Torts § 402(b)* (requiring reliance).

35. This is, in essence, Professor Murray's test. See Murray, "Basis of the Bargain: Transcending Classical Concepts, 66 Minn. L. Rev. 283 (1982).

173 Prelim. Rpt., Part 3, *supra* p. 1088. This focus is set out in the introduction to Rec. A2.3(10).

contract was made.<sup>174</sup> In the middle, some supported the "presumption" test stated in the comments and, with clarifications, were content to leave the matter for the courts.<sup>175</sup>

The recommendation of the Group took the form of urging the Drafting Committee:

to resolve the debate over this important issue without returning to an explicit reliance test. More particularly, the solution should (1) Incorporate the "presumption" test, now stated in the comments, into the text of section 2-313; (2) Clarify whether the affirmations governed by section 2-313(2) are part of the "presumption" test; and (3) Elaborate when a promise or representation made after contract formation becomes part of the bargain.<sup>176</sup>

In view of the widespread disagreement between members of the Study Group over what test should apply to "basis of the bargain," it is unfortunate that the recommendation calls for incorporating the "presumption" test into the statutory text. Given the disagreement, it seems unlikely that the Study Group intended to adopt the comprehensive "presumption" test approach urged by White and Summers or any other specific presumption jurisprudence pressed by other commentators.<sup>177</sup> Rather, it must mean simply moving to the statute language from (or similar to) current Official Comments 3 and 8 which declares that statements are

---

174 "This is, in essence, Professor Murray's test. See Murray, 'Basis of the Bargain,' *Transcending Classical Concepts*, 66 MINN. L. REV. 283 (1982)."

175 Prelim. Rpt., Part 3, *supra* p. 1088-89. The disagreement among Committee members is evidenced in the introduction to Rec. A2.3(10).

176 Prelim. Rpt., Part 3, Rec. A2.3(10), *supra* p. 1089. The Study Group's concern about the possibility that proof of representations might be foreclosed by the parol evidence rule when made prior to a writing which contains a merger clause is discussed *supra* under U.C.C. § 2-202.

177 One sentence of the Study Group's commentary regarding § 2-318 could be read to embrace a White and Summer's type presumption approach. It reads:

All agree that if the remote seller has made an express warranty through advertising or otherwise to the buyer that became part of the basis of the buyer's bargain with its seller, a suit against the remote seller should be allowed. Consistent with our recommendations regarding §2-313, the remote seller should be permitted to show that the representations did not in fact become part of the buyer's bargain.

Prelim. Rpt., Part 3, *supra* p. 1113.

On closer reading, however, it does not purport to resolve the question. It simply says the issue is basis of the bargain without indicating how that issue is to be resolved.

presumed to be part by the basis of the bargain unless taken out by "clear affirmative proof" or for "good reason . . . shown to the contrary."<sup>178</sup> That much can be regarded as a beginning point for most views of "basis of the bargain." Although such a step would be helpful, it does not purport to resolve much of the disagreement that exists in both the Study Group and the commentators.

The second recommendation, seeking clarification on whether those affirmations governed by section 2-313(2) are part of the "presumption" test, could contemplate simply a rewrite of current Comment 8. Surely the clear import of that language is that if something is an affirmation which survives a puffing challenge, it is to be treated the same as any other affirmation. Perhaps the Study Group finds confusion in the separate statement of that notion. Thus, it may be useful for the Drafting Committee to attempt to deal comprehensively with "basis of the bargain" in such a way as to encompass what is now separately stated in two sub-sections.

The third recommendation, proposing elaboration on when a promise or representation made after contract formation becomes a part of the bargain, raises issues both for section 2-313 and for section 2-209.<sup>179</sup> However, this part of the Study Group Report considers only the section 2-313 issues.<sup>180</sup> Implicit in the recommendation is the conclusion that Comment 7 is no longer adequate to the task. In view of the difficulties in some of the cases and the diverse views of commentators, some clarification is desirable.

a. *A Brief History of Warranty Shaping "Basis of the Bargain."*

Re-evaluation of standards for "basis of the bargain" necessitates a comprehensive review of the nature of warranty obligation. Some history is essential since the current language of section 2-313 refers directly or indirectly to several distinctly different bases of obligation.

---

178 U.C.C. § 2-313 comments 3, 8 (1990).

179 Promises or representations made after the contract, which have not become part of the basis of the bargain, are by definition not warranties. They may, however, constitute a modification of the contract or operate as a waiver under U.C.C. § 2-209. *See, e.g.*, B. CLARK & C. SMITH, *LAW OF PRODUCT WARRANTIES* ¶¶ 4.03[4], 4.04[3][f] (1984) (citing discussion and cases).

180 The § 2-209 issues are considered in recommendations of the Report.

Most law students in recent decades have been exposed to Prosser's inimitable description of the "curious hybrid" of warranty, "born of the illicit intercourse of tort and contract, unique in the law."<sup>181</sup> This serves as fair warning of some complexity. Professor Vold used "a convenient figure of speech" to describe the "triple nature" of the warranty obligation:

prong no.1, the promissory warranty, is strictly contractual; prong no.2, the warranty obligation based on the seller's representations inducing the deal, is independently imposed by law, comparable to tort obligations; prong no.3, also is independently imposed by law, apart from seller's representations, for strictly public policy reasons.<sup>182</sup>

Moreover, each of these bases of warranty developed separately with some overlap over a period of time to reflect strikingly different underlying philosophies.

(1) *Separate Contract*. Early on, warranty was not considered part of the sales contract. Originally, a buyer of goods was obligated to pay for and receive goods regardless of any defects in them. The only ground for objection was that the object delivered was not that which was contracted for. Thus, if a buyer wanted quality protection, he was obliged to find it in a separate contract of warranty.<sup>183</sup> That separate obligation in turn was rooted in rigorous requirements, as special words of warranty<sup>184</sup>—what Rabel has called "solemn assumption of liability"<sup>185</sup>—were necessary.

(2) *Express Assumption and Representations With "Intent."* The initial insistence on solemn assumption gradually gave way to express assumption and then representations made with intent to assume liability. Gradually, "though the requirement of intent was generally stated, the natural meaning of the word was explained

---

181 W. PROSSER, TORTS 634 (4th ed. 1971).

182 *Id.* at 427. Prosser's trilogy is similar. See Prosser, *The Implied Warranty of Merchantable Quality*, 27 MINN. L. REV. 117, 119-25 (1943).

183 Rabel, *The Nature of Warranty of Quality*, 24 TULANE L. REV. 273, 279 (1950) (discussing the famous discourse of Baron Parke).

184 See Stoljar, *Conditions, Warranties and Descriptions of Quality in Sale of Goods*, 15 MOD. L. REV. 425, 427 (1952).

185 Rabel, *The Nature of Warranty of Quality*, 24 TULANE L. REV. 273 (1950).

away”<sup>186</sup> so that Benjamin, in his treatise on sales, could correctly summarize English law regarding intent to warrant as follows:

In determining whether it was so intended, a decisive test is whether the vendor assumes to assert a fact of which the buyer is ignorant or merely states an opinion or judgment upon a matter of which the vendor has no special knowledge, and on which the buyer may be expected also to have an opinion and to exercise his judgment.<sup>187</sup>

Many American cases generally developed along the lines of the Benjamin articulation, construing intent *not* to mean “intent to contract or to agree to be bound, but rather an intent to make a statement as matter of fact rather than as matter of opinion.”<sup>188</sup> Williston applauded those American decisions which avoided the use of the word “intent” altogether and followed a similar course in his drafting of the Uniform Sales Act.<sup>189</sup>

(3) *Fact v. Opinion, Exaggerations; Influence of Tort Misrepresentations Cases.* These developments regarding representations also appeared in the tort law of misrepresentation, with sales warranty and misrepresentation cases cited interchangeably for a number of propositions. Illustrative are those cases in which efforts were made to distinguish “fact” from “opinion,” the effect of statements of value, and whether liability could attach to representations tinged by exaggeration, extravagant language, flattery and the like.

Of course, the classic tort of deceit included the independent

---

186 I. WILLISTON, *THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT* § 198, at 509 (rev. ed. 1948).

187 *Id.* (noting the statement appeared in the first six editions of Benjamin and was adopted by the English Court of Appeal in 1901). The seventh edition substituted for “a decisive test,” “a valuable, though not decisive, test” to take into account a 1913 House of Lords case which (in Williston’s view) mistakenly reverted to the older view. The current successor edition of Benjamin’s *Sale of Goods* indicates that the older view emphasizing “that liability is only to be imposed where the person giving the warranty can fairly be regarded as having made a contractual promise,” *id.* § 744, at 352, continues, although mitigated by “the general tendency over the whole law of contract in the twentieth century to treat statements and acts objectively and to place emphasis on the impression they reasonably create” producing “a movement towards the readier imposition of liability.” *Id.* § 746, at 353. Some of the deficiencies of English law pertaining to misrepresentations in sale of goods cases were addressed in the Misrepresentation Act 1967. See BENJAMIN’S *SALE OF GOODS* § 738 (A. Guest 2d ed. 1901).

188 WILLISTON, *supra* note 186, § 200, at 512.

189 *Id.* § 201, at 514. Uniform Sales Act § 12, defining express warranty, contains no reference to the concept of intent.

element of reliance. Thus, it is not surprising that even in the sales warranty cases discussing liability for representations involving opinion or puffing, language of reliance appeared. Indeed, such language became an element of that stream of sales warranty law founding liability on representations and was written into the Uniform Sales Act definition of express warranty. But, it no longer bore the old tort of deceit meaning.<sup>190</sup> More importantly, it was neither a part of those streams of warranty law predicated liability on promises or solemn affirmations or intention—nor a part of those, to be discussed below, rooted in public policy.

(4) *Liability Imposed by Law.* Warranty liability imposed by law is reflected in two very significant lines of cases. The first is that which began as the warranty of description and ended as the implied warranty of merchantability. The second is that line of cases involving personal injury in which the courts found it convenient to use some of the terminology, if not all the trappings, of sales warranty law. The latter, of course, has in the last several decades virtually splintered off and evolved independently into strict liability in tort.

(a) *The Warranty of Description and the Evolution of Merchantability.* At root, the common law cases dealing with description concern basic notions of fairness and fair play. Even in the heyday of caveat emptor, the law required sellers to deliver what they had contracted to deliver. "Nothing is more elementary in all the law of contract than that an agreement to deliver a horse is not satisfied by delivery of a cow."<sup>191</sup> Gradually the cases began to use language that called for quality, as courts began to acknowledge the shortcomings of the old caveat emptor doctrine in transactions which did not involve face to face haggling over goods physically within the view of the parties. The sale of goods unseen by the buyer was characterized

---

190 See, e.g., WILLISTON, *supra* note 186. Even in tort, reliance has become another way of inquiring whether a statement is important enough to induce action or whether it is reasonable for someone to act on it. See W. PROSSER & P. KEETON, TORTS § 109, at 755 (4th ed. 1971). Whether, for example, something is to be labeled as "fact" or "opinion" is no longer the issue.

191 PROSSER *supra* note 181, at 125. *Accord* Gore v. Ball, 279 N.C. 192, 200, 182 S.E.2d 389, 393 (1971) (Lake, J.):

One who contracts to sell to another a Jersey cow is liable for damages for breach of contract if he delivers a mule, or even an Angus cow, notwithstanding his statement, in the contract of sale, that he made no warranty as to the qualities of the cow he contracted to sell [sic] and deliver.

as a sale "by description."<sup>192</sup> Conformity to description required determination of "the real mercantile or business description" of the goods which, in order to "answer that description" had to be "salable or merchantable."<sup>193</sup> This reasoning led to the much quoted expression of Lord Ellenborough in *Gardiner v. Gray*:<sup>194</sup>

[T]he purchaser has a right to expect a saleable article answering the description in the contract. Without any particular warranty, this is an implied term in every such contract. Where there is no opportunity to inspect the commodity, the maxim of *caveat emptor* does not apply. He cannot without a warranty insist that it shall be of any particular quality or fineness, but the intention of both parties must be taken to be that it shall be saleable in the market under the denomination mentioned in the contract between them. The purchaser cannot be supposed to buy goods to lay them on a dunghill.<sup>195</sup>

It is clear that this "implied" obligation was imposed by law, i.e., it arose irrespective of the agreement of the parties. The foundation for the implied warranty of merchantability was clearly laid.

It was also clear that, prior to the acknowledgement of the warranty of merchantability as such, the description cases dealt not only with identification of the goods but also with enough of the characteristics of the goods to be sure that what was described was delivered. To borrow an apt phrase, the concern was not simply "*which* goods are being sold, but *what* the goods actually are."<sup>196</sup>

This quality content of the warranty of description surfaced in several contexts. One of these was disclaimer. Thus, a "copper fastened vessel, to be taken with all faults" was construed to mean only such faults consistent with a copper fastened vessel as the term was understood in the trade.<sup>197</sup> "From this it is a short step

---

192 Over time, the concept of sale "by description" was not confined to circumstances where the goods were unseen at the time of contract. See P. ATIYAH, *THE SALE OF GOODS* 110-11 (7th ed. 1985).

193 *Randall v. Newson*, 2 Q.B. 102, 109 (1877).

194 4 Campbell 143, 16 Rev. Rpts. 764 (1815).

195 *Id.* at 144, 16 Rev. Rpts. at 765.

196 See ATIYAH, *supra* note 192, at 108.

197 Prosser, *supra* note 182, at 160 (quoting language from *Shepherd v. Kain*, 5 B. & Ald. 240, 106 Eng. Rep. 1180 (1821)).



to construe the description as calling for goods of the kind sold on the market, merchantable under the description, and to hold that a disclaimer in general terms does not exclude the minimum warranty of merchantable quality."<sup>198</sup> The ground was thus laid for an overlap between the obligations of description and merchantability, although each performed separate—and continuing—functions.

The obligations of description and merchantability were carried over into the English Sale of Goods Act 1893 and from there to the Uniform Sales Act.<sup>199</sup> Section 14 of the Uniform Sales Act provided that, where goods were bought "by description," there was an *implied* warranty that the goods "shall correspond with the description."<sup>200</sup> Section 15(2) provided for the implied warranty of merchantability where the goods were bought by description from a seller who dealt in goods of that description. The Uniform Commercial Code drafters reassigned the description obligation to the status of express, rather than implied obligation, and removed the requirement that the sale be one "of description" to qualify for the warranty of merchantability.

The Code transformed the warranty of description from implied to express status for two reasons: (1) to overcome difficulties that had arisen under the Sales Act in determining whether a particular warranty was an express warranty or an implied warranty of description,<sup>201</sup> and (2) to circumvent problems encountered in some cases involving disclaimer of implied warranties.<sup>202</sup> Thereafter, a disclaimer of implied warranties would have no effect on warranties arising out of a description of the goods.<sup>203</sup> The Uniform Sales Act requirement that a sale be "by description" before the implied warranty of merchantability would attach was regarded as an "anachronism" which resulted from copying some, but less than all, the language of several sections of the English Sales of

---

198 *Id.*

199 The Uniform Sales Act, however, classified both obligations as "warranties", abandoning the confusing difference drawn in the English Act between "conditions" and "warranties."

200 Uniform Sales Act § 14 (1906).

201 W. HAWKLAND, SALES AND BULK SALES 36 (1958).

202 *See id.* at 36-38 (discussing *Fairbanks, Morse & Co. v. Consolidated Fisheries Co.*, 94 F. Supp. 311 (D.C. Del. 1950), *rev'd*, 190 F.2d 817 (3d Cir. 1951)). The same change was made with respect to warranties applicable to samples for the same reasons.

203 *See* U.C.C. §§ 2-316, 2-317 (1990).

Goods Act. It was, therefore, omitted to "remove a source of possible confusion."<sup>204</sup> The changes made also clearly preserved the separate identities of the warranties of description and merchantability.

(b) *Influence of Sales Warranty Cases Involving Personal Injuries.* Seller and manufacturer liability for personal injuries caused by defective goods is presently thought of as a matter of course in terms of strict liability in tort. However, the bridge to that current doctrine was borrowed or adapted from sales law to circumvent some of the tactical disadvantages of suits in negligence. For some time, the sales trappings were retained, even while some traditional sales doctrines—in particular, privity of contract—were breached on grounds of public policy until, finally, strict liability in tort was declared to be separate and apart from sales law.

Despite the current separation of strict liability in tort from sales law, the years of developments on the sales side remain as strong evidence of obligations imposed as a matter of law. These obligations were not only in the form of an expansive concept of "implied warranty," but also in strong public policy underpinnings for permitting suits against non-privy sellers—sometimes reasoned on a finding of express assurances made to the ultimate buyer or the courting of the public through advertising and promotions. Some of the reasoning of those cases has continued to influence such issues as privity of contract.

(c) *"Basis of the Bargain" as a Unifying Concept for Disparate Foundations.* In light of this history, it is not surprising that the Code draftsmen chose language which was broad enough to encompass the various strands of warranty law evolution, including representation (with overtones of reliance), promise, language of solemn assumption, and obligation rooted in public policy. In addition, it may be suggested that "basis of the bargain" represents a level of abstraction that encompasses the somewhat more definitive concepts of puffing, opinion, affirmation, description and model. It is a generic statement that helps give content to the others. For example, puffing is regarded as language which one is not entitled to rely on. Therefore, language that one is not entitled to rely on will not become a part of the basis of a bargain.

---

204 1 J. HONNOLD, NEW YORK LAW REVISION COMMISSION, STUDY OF UNIFORM COMMERCIAL CODE, ANALYSES OF SECTIONS OF ARTICLE 2, at 335, 396 (1955).

This approach, of course, can become almost tautological in nature: whether the representation, affirmation, description, sample or model should be considered a part of the seller's obligation because it is either implicit in the bargain of the parties or is imposed for reasons of public policy.

Such a view of "basis of the bargain" should color the Official Comments. It also has strong implications for resolving privity issues, the "generic description" debate<sup>205</sup> and whether there should be liability for statements made both before and after the sale.

(d) *Basis of the Bargain and Affirmations Removed in Time and Space*. Although the cases have touched on a number of aspects of the role of reliance, they have not yet provided a framework for a unified approach to the variety of fact situations ranging from affirmations made long before the closing (as in advertising) through affirmations made shortly after closing to those made considerably after closing. Also unresolved are those cases in which reliance on express affirmations is not affirmatively shown and those in which reliance cannot be shown. Some commentators have attempted to articulate such a unified approach. A look at two such attempts is illuminating.

i) *White and Summers: The Comment 3 Presumption*.

White and Summers begin by contrasting the reliance requirement of the Uniform Sales Act with the murky Code language. They canvass some of the possibilities: "It is possible that the drafters did not intend to change the law, or that they intended to remove the reliance requirement in all but the most unusual case, or that they intended simply to give the plaintiff the benefit of a rebuttable presumption of reliance."<sup>206</sup>

While acknowledging a variety of judicial responses,<sup>207</sup> their choice is a form of presumption which is predicated, in part, on Official Comment 3 which provides: "no particular reliance on [a seller's affirmations during a bargain] need be shown . . . . Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof."<sup>208</sup> This means, they

---

205 Compare J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 9-4 (3d ed. 1988) with CLARK & SMITH, *supra* note 178, ¶ 4.02[2][b].

206 WHITE & SUMMERS, *supra* note 205, § 9-5, at 449.

207 *Id.* at 400 n.3.

208 U.C.C. § 2-313 comment 3 (1990).

say, that the plaintiff "need put in no evidence unless the defendant offers evidence of the buyer's nonreliance . . . ." <sup>209</sup> Where suit is on a statement made orally during the negotiation or in the written contract, seller's motion for a directed verdict should be denied "even though plaintiff has not put on proof of reliance." <sup>210</sup> But, where the statement at issue is removed in time and place, the plot thickens.

White and Summers assert that "[i]t is clear that an advertisement can be a part of the basis of the bargain, and it is only fair that it be so." <sup>211</sup> However, they insist, in approving a decision of the Missouri Court of Appeals, they insist "[a]t minimum a plaintiff in such a case should have to testify that he (or his agent) <sup>212</sup> knew of and relied upon the advertisement in making the purchase." <sup>213</sup> As to statements made after the sale is concluded, they distinguish between those made while the deal is still warm and those made some time later. Where the statement is made before the buyer has "passed the seller's threshold," the buyer, as a matter of empirical fact, will have the power to get the seller to take the goods back and undo the sale. <sup>214</sup> Thus, calling such statements "express warranties recognizes the practical realities even though it does some violence to normal contract doctrine." <sup>215</sup> On the other hand, later statements should not be effective as warranties unless they qualify as modifications under section 2-209. <sup>216</sup>

ii) *Clark and Smith: The Objective View.*

Clark and Smith also catalogue the possibilities, citing case law support for: (1) requiring a strict showing of reliance, (2) dispensing with any showing of reliance, and (3) the middle ground

---

<sup>209</sup> WHITE & SUMMERS, *supra* note 205, § 9-5, at 451.

<sup>210</sup> *Id.*

<sup>211</sup> *Id.* at 401.

<sup>212</sup> They cite and approve several cases in which a representation was made to the plaintiff's employer or her doctor or her seller. *Id.* at 402.

<sup>213</sup> *Id.* at 401.

<sup>214</sup> *Id.* at 403.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.* White and Summers suggest that some post-deal statements that could not qualify as warranties might be the basis for a tort action under § 402B of the Restatement (Second) of Torts. However, recovery under that rule is limited to a "consumer who suffers physical harm caused by justifiable reliance on the misrepresentation" made in the course of advertising.

of a rebuttable presumption of reliance grounded in Comment 3. In their view, the first line is wrong because it is clear the drafters intended to do away with a strict requirement of reliance; the word was used in section 2-315, and Official Comment 3 to section 2-313 says "no particular reliance need be shown."<sup>217</sup> On the other hand, the second line goes too far because it ignores that mysterious "basis of the bargain" language which must mean something.<sup>218</sup> The middle ground espoused by White and Summers is also not satisfactory because it leaves unclear the kind of evidence and the standard of evaluation which are necessary to rebut the presumption and, in turn, the amount of evidence the buyer must produce to establish reliance.<sup>219</sup> The better solution, in their view, is an objective test under which a seller's representations are deemed to be a part of the basis of the bargain

unless the seller can show that a reasonable buyer would not have relied on the representations if they were brought to his attention before the sale was consummated. This objective approach shifts the focus from the buyer's state of mind to the expected impact of affirmations made by the seller once he launches a product on the market. If these affirmations are precise enough, the seller should be required to stand behind the goods.<sup>220</sup>

They find support for this objective approach in the much cited quotation of Williston,<sup>221</sup> in the writings of other commentators, and in the "thrust of some of the better reasoned decisions."<sup>222</sup>

They perceive several advantages in this view. It recognizes the large overlap between "basis of the bargain" and "puffing." It eliminates the need for indulging in such fictions as treating

---

217 CLARK & SMITH, *supra* note 179, ¶ 4.03[3], at 4-32.

218 *Id.*

219 *Id.* ¶ 4.03[2][c], at 4-31.

220 *Id.* ¶ 4.03[3], at 4-33.

221 There is danger in giving greater effect to the requirement of reliance than it is entitled to. Doubtless the burden of proof is on the buyer to establish this as one of the elements of his case. But the warranty need not be the sole inducement to the buyer to purchase the goods; and as a general rule no evidence of reliance by the buyer is necessary other than the seller's statements were of a kind which naturally would induce the buyer to purchase the goods and that he did purchase the goods. S. WILLISTON, WILLISTON ON SALES § 206, at 534-35 (rev. ed. 1948).

222 CLARK & SMITH, *supra* note 179, ¶ 4.03[3], at 4-33.

third parties as agents for reliance, and it "does away with the need for tenuous allegations of reliance by a particular buyer, a recurrent theme in decided cases."<sup>223</sup> They also point out that the objective test overcomes the problem of the post-agreement warranty.<sup>224</sup>

iii) *An Evaluation.*

The Clark-Smith view represents a unified approach that seems quite workable. It is sufficiently pervasive to encompass the different strands that have evolved into modern warranty law while being far better suited than the Comment 3 presumption approach to cope rationally with the ubiquitous modern warranty and its accompanying pre- and post-sale advertising and marketing blitzes. Surely one should not be surprised that the law regarding the role of reliance in express warranties is in the process of change. It is part of that same laborious evolution that, in response to changing circumstances ranging from the industrial revolution to modern marketing methodology, in turn: (1) de-formalized warranty (2) gradually imposed it as a matter of law in transactions where the goods were not present at the time of the sale because buyers could not, in such circumstances, rely on their own inspection, and (3) enlarged that implied warranty obligation to reach even the classic face to face transaction.

In light of the fact that one strand of the law of warranty once required a showing of "intent to warrant," it is ironic that the presumption approach to advertising and even unread warranties would deny liability even for statements which on their face show evidence of intent on the part of the seller to affirm product quality or stand behind its products. It is even more ironic that White and Summers concede that "[t]he next twenty years may see the reliance requirement go the way of the Nineteenth Century requirement that a seller intend to warrant; that is, it may disappear altogether."<sup>225</sup>

---

223 *Id.* ¶ 4.03[3], at 4-33-34.

224 *Id.* ¶ 4.03[4], at 4-34.

225 WHITE & SUMMERS, *supra* note 205, § 9-5, at 455.

Why should a buyer who has not read an advertisement or an owner's manual not have the advantage of a warranty when he is paying the same price as one who has read the advertisement or owner's manual and will have warranty protection? A warrantor who publishes affirmations which pass beyond the line of puffing must contemplate the possibility that every potential purchaser will read and rely on them. Presumably, that warrantor, engaging in such activity to induce reliance and promote sales, will price its product to include the cost of the warranty. Why should it not be required to stand behind its affirmations even if an individual buyer has not demonstrated direct reliance?

Enforcing warranty liability in these situations does not pose the spectre, contemplated in the famous phrase of Cardozo with respect to accountant liability, of "liability in an indeterminate amount for an indeterminate time to an indeterminate class."<sup>226</sup> A recent North Carolina decision,<sup>227</sup> updating the law of accountant liability, suggests several grounds for distinction. Those persons supplying goods have control over the processes by which products enter commerce (including, it should be added, the publication of affirmations which constitute warranties), they can limit potential liability by controlling the number of products released and they "fully expect that their products will be used by a wide variety of unknown members of the public. Indeed, this is their hope . . . ."<sup>228</sup> Why should they be permitted to escape warranty liability when that hope is fulfilled?

(e) *Comment Reference to Factual Underpinnings.* One matter that should be amplified in the Comments is an emphasis that "basis of the bargain" is both highly factual and contextual, especially in the puffing cases. This appears to be common wisdom among the commentators who stress the importance of identifying relevant factors in reading cases.<sup>229</sup> Such catalogue might include such factors as the specificity of the seller's statement, the relative expertise and commercial status of the parties, the other terms of the contract,

---

<sup>226</sup> *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 179-80, 174 N.E. 441, 444 (1931).

<sup>227</sup> *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 201, 367 S.E.2d 609 (1988).

<sup>228</sup> *Id.* at 213, 367 S.E.2d at 616.

<sup>229</sup> *See, e.g.*, CLARK & SMITH, *supra* note 179, ¶ 4.02[4]; WHITE & SUMMERS, *supra* note 205, § 9-4.

the nature (if any) of the buyer's reliance, the gravity of the defect in the goods, the extent of damage attributable to the defect and even the strength of the evidence apparently available to establish breach and damages. One problem in an effort of this sort is that some of the matters suitable for inclusion in the catalogue—such as the last three enumerated here—do not pertain to the theoretical question of whether a warranty exists, even though they may be helpful in trying to reconcile the cases.

*2. Are Warranties Made by Remote Sellers Covered by the Language of Section 2-313?*

The present section 2-313 does not directly address the issue of warranties made by remote sellers, and Comment 2 shows that the drafters finessed the issue.<sup>230</sup> Thus, despite the fact that many such warranties are regularly enforced by courts, the language of the provision does not really fit the situation. For example, the language speaks of an affirmation of fact or promise "made by the seller." Is the remote seller a "seller" in relation to the ultimate buyer? Likewise, how can an affirmation or promise made by the remote seller become part of the basis of the buyer's bargain with the retailer? Isn't the bargain, after all, between the buyer and the retailer?<sup>231</sup>

The problem, of course, not only implicates warranties, but remedies as well, as the Study Group acknowledges in a list of issues that a Drafting Committee must examine if privity is not required.<sup>232</sup>

Such remote seller warranties are pervasive. Where they relate to consumer goods and are in writing, the federal Magnuson-Moss

---

230 U.C.C. § 2-313 (1990). Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. The provisions of § 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.

231 Of course, the retailer may adopt the remote seller's warranty. However, that would serve only to bind the retailer to the remote seller's promises, not necessarily to bind the remote seller directly to the buyer unless it could somehow be said that part of the deal between the retailer and the remote seller was the latter's authorization for the former to bind it directly to the buyer.

232 Prelim. Rpt., Part 3, Rec. A2.3(15)(B), *infra* p. 1114.



Act, in effect, overcomes the Article 2 privity problem by granting standing to the ultimate buyer and certain others<sup>233</sup> but does not deal with the remedy issues. Lemon laws in most states, albeit in non-uniform fashion, deal with both privity and remedy problems when new automobiles are involved.<sup>234</sup> In addition, case law generally imposes liability on the remote seller for violations of warranty promises addressed in form to an ultimate buyer.<sup>235</sup>

Thus, we have a situation in which remote seller warranties are both common and enforced. But, are they warranties within section 2-313? In view of the language of "seller" and "bargain," they appear not to be, although most cases do not confront this inconvenience. What then are they?

Professor Reitz concludes that they are common-law warranties which can be recognized by virtue of section 1-103<sup>236</sup> and notes that "like warranty theory in the distant past, warranty obligations may be independent of contract." Distant past indeed! As indicated above,<sup>237</sup> the warranty as separate contract analysis applied at the earliest stages of warranty liability.<sup>238</sup> Originally, the separate contract was between buyer and seller. However, the concept was also applied to create warranty liability between an ultimate consumer and a manufacturer. Indeed, this was one of the bases of decision in *Henningsen v. Bloomfield Motors, Inc.*<sup>239</sup> In dealing with the warranty made by the manufacturer, the court said, "The consideration for this warranty is the purchase of the manufacturer's product from the dealer by the ultimate buyer."<sup>240</sup>

Surely a rewritten statute should be drafted broadly enough to encompass such commonly used warranties. Further, the drafting should be broad enough to encompass representations in advertising which are broadly addressed to the public. In order to avoid

---

233 See 15 U.S.C. §§ 2301(3), 2310(d) (1990).

234 See *supra* p. 1003 accompanying notes 27-28.

235 See, e.g., NATIONAL CONSUMER LAW CENTER, SALES OF GOODS AND SERVICES ch.19 (2d ed. 1989).

236 Memorandum by Reitz, "Warranties by Remote Manufacturers," prepared for the Study Group, at 5 (1989). He puts Magnuson-Moss written warranties into the same category for Code purposes.

237 See *supra* text accompanying notes 183-85.

238 The separate contract was often referred to as a collateral contract, a notion that still persists in England. See BENJAMIN, *supra* note 187. Because of the confusion engendered, the Uniform Sales Act drafted around the concept.

239 32 N.J. 358, 161 A.2d 69 (1960).

240 *Id.* at 374, 161 A.2d at 78.

problems of reliance, the language might provide that representations (which survive a puffing test) addressed to segments of the public to which the buyer belonged would be part of the basis of the bargain—just as express promises.

*[PRELIMINARY REPORT - 2-314]*

**P. IMPLIED WARRANTY: MERCHANTABILITY; USAGE OF TRADE: § 2-314.**

**Rec. A2.3 (11).**

*No revisions are recommended in the text of § 2-314. Some revisions in the comments, however, are recommended.*

1. *Merchant seller. A warranty of merchantability shall be implied when the "seller is a merchant with respect to goods of that kind." § 2-314(1). This is a less expansive definition of merchant than that contained in § 2-104(1). The definition is further narrowed by a sentence in Comment 3, which states that a "person making an isolated sale of goods is not a 'merchant' within the meaning of the full scope of this section. . . ."*

*(A) We recommend that this sentence be deleted. If the seller otherwise qualifies as a merchant, a limited volume of actual sales should be irrelevant.*

2. *Auctioneer. It is not clear when an auctioneer is a seller who makes an implied warranty of merchantability.*

*(B) We recommend that when an auctioneer is a seller be clarified in a comment.<sup>36</sup>*

3. *Merchantability. In general, courts have had little trouble working with the definitions of merchantability in § 2-314(2). The question in most cases is whether the buyer has proved that the goods, whether new or used, were unmerchantable at the time of tender.<sup>37</sup> One problem is whether well made goods, i.e., cigarettes, fish, butter, blood or whiskey, whose natural ingredients create risks are unmerchantable. Are they "fit for the ordinary purposes for which such goods are used?" § 2-314(2)(c). The answer is unclear, and may depend upon the circumstances in each case.*

*(C) We recommend that the Drafting Committee prepare a new comment for guidance on this question. In addition, we recommend that the last sentence in § 2-314(1), which deals with whether the*

---

36. See Revision at 408-410 (recommending that this problem be specifically addressed).

37. In general, the buyer must prove both the ordinary purposes for which such goods are used and that particular characteristics of the goods made them unfit for ordinary purposes. *Bethlehem Steel Corp. v. Chicago Eastern Corp.*, 863 F.2d 508, 513 (7th Cir. 1988).

*“serving for value of food or drink to be consumed either on the premises or elsewhere,” be reviewed and coordinated with any revision in § 2-102.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-315]

*Q. IMPLIED WARRANTY: FITNESS FOR PARTICULAR PURPOSE: § 2-315.*

*No revisions are recommended in § 2-315.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-316]

*R. EXCLUSION OR MODIFICATION OF WARRANTIES: § 2-316.*

*We will deal with § 2-316(1) subsection by subsection.*

*1. Express warranties: § 2-316(1).*

*§ 2-316(1) renders a disclaimer of an express warranty “inoperative” if the two terms cannot reasonably be construed as consistent. This policy decision is subject to the parol evidence rule, § 2-202, and raises the risk that a standard form “merger” clause may exclude an express warranty made before the contract was signed, even though it is still part of the buyer’s actual expectations.*

*Rec. A2.3 (12).*

*The Study Group does not recommend that the reference to § 2-202 be deleted from § 2-316(1). Rather, we recommend that § 2-202 be revised to ensure that the buyer is not unfairly surprised by the merger clause. One possible revision is to require that the merger clause be “separately signed” by the other party. See §§ 2-205 & 2-209(2). Another possibility is to draft a new comment requiring proof that the buyer expressly assented to the merger clause.*

*A new comment in § 2-202 should also clarify when, if ever, a general merger clause excludes an implied warranty of merchantability or fitness.*

2. *Implied warranties: § 2-316(2).*

*Rec. A2.3 (13).*

*The following revisions and clarifications are recommended in the text of § 2-316(2):*

*(A) A conspicuous disclaimer of the implied warranty of merchantability should not be effective unless it is in writing and mention merchantability.*

*The addition of the writing requirement achieves parity with the fitness warranty and parallels § 2A-316. The consensus was, however, that § 2-316(2) should not be revised to require the seller to communicate additional information to the buyer. The buyer is expected to understand from a conspicuous, written disclaimer using the word "merchantability" that it assumes the risk that the goods will not be fit for ordinary purposes.*

*Some members of the Study Group disagreed with that conclusion, especially where consumer buyers are involved. Perhaps some reconsideration of the statutory approved words would help this issue. Compare § 2A-214(2) on "fitness."*

*(B) The majority of the Study Group concluded that the text should be revised to indicate that a disclaimer of which the buyer has knowledge it should be effective even though the definition of "conspicuous" in § 1-201(10) was not satisfied.*

*In short, in this case substance (no surprise in fact) should control form (the prevention of unfair surprise).<sup>38</sup> Some members of the Study Group thought that form should be preserved, both to insure the consistent communication of essential information and to avoid evidentiary conflicts over how much the buyer actually knew.<sup>39</sup>*

*(C) A bare majority of the Study Committee agrees that the courts should be free to apply the general principle of § 2-302 to invalidate disclaimers that comply with the formal requirements of § 2-316(2). This interpretation should be made clear in a comment to § 2-316(2). See Rec. A2 3(B) and accompanying discussion.*

*In short, § 2-316(2) should not be the exclusive statement of unconscionability where disclaimers of implied warranties are involved. Exactly what the residual principles are should be worked out on a case by case basis.*

---

38. *Accord: Twin Disc, Inc. v. Big Bud Tractor*, 772 F.2d 1329, 1635, n. 3 (7th Cir. 1985). Cases to the contrary are discussed in *Update* at 1270-71, *supra* at note 32.

39. See *White & Summers* at 502.

3. § 2-316(3).

§ 2-316(3) provides for other circumstances that may exclude or limit an implied warranty.

No revisions are recommended in the text of § 2-316(3)(b) and (c).<sup>40</sup>

(D) § 2-316(3)(a) should be revised to require that the language of exclusion treated there, if put in writing, must be conspicuous.

As now drafted, § 2-316(3)(a) does not clearly require that language of disclaimer, such as "as is," which is actually contained in a writing be conspicuous. In this case, we recommend that parity with § 2-316(2) be achieved. On the other hand, we are less clear that such language must be in writing, especially if that language is actually communicated to the buyer. Under those circumstances, the current draft of § 2-316(3)(a) appears to provide sufficient protection.

4. § 2-316(4).

No revisions are recommended in § 2-316(4).

[TASK FORCE - 2-316]

SECTION 2-316

1. 2-316 (1): *Merger Clauses and the Parol Evidence Rule*. For discussion of this issue see the discussion of Section 2-202.

2. *Exclusion of Modification of Implied Warranties: Section 2-316(2)*.

a) *Merchantability in Writing; Conspicuous "As Is"; Oral Disclaimers*. The Study Group recommends that the current 2-316 be amended to add a requirement that a conspicuous disclaimer of merchantability be in writing and mention merchantability.<sup>241</sup> The change "achieves parity with the fitness warranty and parallels § 2A-316."<sup>242</sup> In addition, the Study Group recommends that the "as is" disclaimer provisions in section 2-316(3)(a) be amended to require that any such language contained in a writing be con-

---

40. Peters suggested that a literal reading of § 2-316(3)(b) shows that a failure to examine the goods before contracting precludes both the right to reject and to recover damages and she questions whether this is sound. Roadmap at 207, note 30.

241 Prelim. Rpt., Part 3, Rec. A2.3(13)(A), *supra* p. 1107.

242 Prelim. Rpt., Part 3, *supra* p. 1107.

spicuous, thus resolving an acknowledged problem.<sup>243</sup> However, the Study Group does not recommend any change in that part of the current provisions which does not require such language to be in writing.

The net result of these recommendations is positive. Because a writing also containing an express warranty involving consumer products would trigger the anti-disclaimer provisions of the Magnuson-Moss Act, the requirement for a writing to disclaim merchantability would indirectly enhance consumer protection. On the other hand, an oral disclaimer would still be possible under an amended subsection (3)(a). Even the brief explanation of the Study Group on the point is hedged: "[W]e are less clear that such language must be in writing, especially if that language is actually communicated to the buyer."<sup>244</sup> Even if the full step of banning any disclaimer of merchantability is not taken, there should be added to the Comments some emphasis on the point. For example, where the "as is" disclaimer is not in writing, it should be actually communicated to the buyer to be effective.

b) *Is the Medium the Message?* The provisions also do not confront the question of whether the word "merchantability" carries the message. It is, almost by definition, a merchant concept. Apparently the Study Group considered the issue since the Report indicates that

[t]he consensus was . . . that § 2-316(2) should not be revised to require the seller to communicate additional information to the buyer. The buyer is expected to understand from a conspicuous, written disclaimer using the word "merchantability" that it assumes the risk that the goods will not be fit for ordinary purposes.

Some members of the Study Group disagreed with that conclusion, especially where consumer buyers are involved. Perhaps some reconsideration of the statutory approved words would help this issue. Compare § 2A-214(2) on "fitness."<sup>245</sup>

---

243 See Leary & Frisch, *Is Revision Due for Article 2?*, 31 VILL. L. REV. 399, 414-15 (1986) (noting that a disclaimer of warranty of merchantability or fitness be conspicuous, but a disclaimer of all warranties with the use of words such as "as is" is not explicitly required to be conspicuous).

244 Prelim. Rpt., Part 3, *supra* p. 1108.

245 Prelim. Rpt., Part 3, *supra* p. 1107.

The referenced section of the new Article 2A governing leases provides that one way to exclude a fitness warranty is to state that "[t]here is no warranty that the goods will be fit for a particular purpose."<sup>246</sup> Another example is the Arizona statute which requires the phrase "as is—not expressly warranted or guaranteed" to disclaim warranties relating to sale of cars.<sup>247</sup> And in Washington, disclaimers of merchantability or fitness "shall not be effective to limit the liability of merchant sellers except only insofar as they set forth with particularity the qualities and characteristics not being warranted."<sup>248</sup> Further consideration should be given to this issue by the Drafting Committee.<sup>249</sup>

c) *Does Knowledge of the Disclaimer Make it Conspicuous?* A majority of the Study Group recommends an amendment to "indicate that a disclaimer of which the buyer has knowledge should be effective even though the definition of 'conspicuous' in section 1-201(1) was not satisfied."<sup>250</sup> There is some ambiguity in the recommendation since the referenced definition of "conspicuous" requires a writing. Presumably, the suggestion is directed only at the size and location

---

246 U.C.C. § 2A-214(2) (1990).

247 ARIZ. REV. STAT. § 28-1327 (1956).

248 WASH. REV. CODE § 62A.2-316(4) (1967).

249 The nature of the problem for consumers is noted in NATIONAL CONSUMER LAW CENTER, SALES OF GOODS AND SERVICES § 17.4.5 (2d ed. 1989) with specific reference to the FTC Used Car Rule:

Most consumer buyers would not even know that there is an implied warranty called merchantability, much less that it can be disclaimed and how. Most consumers probably expect that if goods purchased do not function reasonably well, they can be returned to the seller within a reasonable time. This is, in fact the practice in most retail sales of goods to consumers.

. . . It is unlikely that a consumer buyer knows that [as is] means if the car does not work at all, he must still pay the seller and the seller will have absolutely no obligation. Some consumer buyers may believe that "as is" means "as equipped" or "with scratches and dents." It is also likely that a buyer may believe "as is" simply means the dealer does not promise free repairs for a specific period, that is, that there was no warranty to repair. The "common understanding" of the term "warranty" by consumer buyers generally concerns repairs of an item.

*Id.*

In the view of the publication, the additional language required by the FTC in that circumstance fortifies that understanding. This leads a consumer to conclude that, although the dealer will not pay for repairs, the "car will at least function reasonably well and be free of major defects (warranty of merchantability) or be fit to serve a particular purposes . . . ." *Id.*

250 Prelim. Rpt., Part 3, Rec. A2.3(13)(B), *supra* p. 1107.

of type, not at whether a writing is required. Otherwise, the recommendation would undercut the new recommendation that the disclaimer of merchantability be in writing.

On the merits, the minority has the better case as a rough look at litigation regarding efficacy of disclaimers suggests that merchants have learned how to write them.<sup>251</sup> Also, the minority view is persuasive that "form should be preserved, both to insure the consistent communication of essential information and to avoid evidentiary conflicts over how much the buyer actually knew."<sup>252</sup>

d) *Unconscionable Disclaimers*. Because there has been a thorough canvass by commentators of the relationship between section 2-316(2) and section 2-302, there is surely enough evidence to support the "bare majority" recommendation that "courts should be free to apply the general principle of § 2-302 to invalidate disclaimers that comply with the formal requirements of § 2-316(2)."<sup>253</sup> This interpretation is to be "made clear" in a Comment to section 2-316(2). The subject is more fully discussed in the Study Group's consideration of section 2-302 where the same conclusion is recorded.<sup>254</sup>

The conclusion is clearly consistent with two notions: (1) 2-316 is simply an application of 2-302 and does not exhaust the reach of the latter; (2) while 2-316 provides guidelines for true

---

251 In the early days, much warranty litigation terminated at this level of controversy. It was only after the merchants got their forms right that there was a need to push the frontiers of "failure of essential purpose."

252 Prelim. Rpt., Part 3, *supra* p. 1107. An applicable footnote in the Report says, "See White & Summers at 502."

The other side of the case was made in dicta in *Tennessee Carolina Transp. v. Strick*, 283 N.C. 423, 196 S.E. 2d 711 (1973), where the court suggested further inquiry should be permissible "as to whether the buyer was protected by factors other than the physical conspicuousness of the clause itself."

[C]ertainly *actual awareness* of the disclaimer is another circumstance which protects the buyer from the surprise of unexpected and unbargained language of disclaimer. Perhaps an additional circumstance of this sort arises where, as here, the buyer is a non-consumer with bargaining power substantially equivalent to the seller's.

Where both of these circumstances are shown—the buyer is a non-consumer on substantially equal bargaining terms with the seller and is actually aware of the disclaimer prior to entering the sale contract—possibly the disclaimer should be enforced despite its inconspicuousness, in the absence of a showing of unconscionability, since the purpose of the "conspicuous" requirement has been satisfied.

*Id.* at 434, 196 S.E.2d at 718. If a change is to be made, it should be at least as hedged.

253 Prelim. Rpt., Part 3, Rec. A2.3(13)(C), *supra* p. 1107.

254 Prelim. Rpt., Part 3, Rec. A2.3(1)(B), *supra* p. 1074-75.



negotiated bargains, it may at times be inadequate in other circumstances.

*[PRELIMINARY REPORT - 2-317]*

**S. CUMULATION AND CONFLICT OF WARRANTIES  
EXPRESS OR IMPLIED: § 2-317.**

**Rec. A2.3 (14)**

*No revisions are recommended in the text of § 2-317.*

*Section 2-317 provides principles to resolve conflict when the bargain contains more than one warranty and the intention of the parties as to which dominates is not clear. The approach is to construe the warranties "as consistent" unless this is "unreasonable" and then to fill out intention by certain "rules" of construction.<sup>41</sup> In general, the "rules" give preference to the specific over the more general.*

*§ 2-317(c) provides that "[e]xpress warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose." Arguably, the inconsistent express warranty, whether giving the buyer more or less protection than the implied warranty, should control in both cases. The Study Group disagreed on this point, however, and recommends no revision in the text of § 2-317.<sup>42</sup>*

**[TASK FORCE - NONE]**

*[PRELIMINARY REPORT - 2-318]*

**T. THIRD PARTY BENEFICIARIES OF WARRANTIES  
EXPRESS OR IMPLIED: § 2-318.<sup>43</sup>**

**1. The Privity Requirement.**

*Background. The current § 2-318, with its three alternatives, is an anachronism. It was drafted before strict tort liability developed in addition*

---

<sup>41</sup> See §§ 1-205(4) and 2-208(2), where a similar approach is taken.

<sup>42</sup> Most courts agree that an express warranty of description does not displace an implied warranty of fitness going to the details of performance or function of the goods. See, e.g., *Singer Co. v. E.I. du Pont de Nemours & Co.*, 579 F.2d 433 (8th Cir. 1978).

<sup>43</sup> We have benefited from an excellent memorandum entitled "Warranties by Remote Manufacturers," prepared for the Study Group by Professor Curtis R. Reitz of the University of Pennsylvania School of Law. See also, C. Reitz, *Consumer Product Warranties Under Federal and State Law* (2d ed. 1987).

to warranty theory where damage to person or property resulted. Furthermore, the stated basis for extension, "third party beneficiaries," is a fiction.

*Rec. A2.3 (15).*

*(A) The Study Committee agreed that a major revision of § 2-318 was required and that whatever the revision, a buyer who suffered damage to person or property and claimed breach of warranty under Article 2 should meet the same privity standards as a buyer who suffered only economic loss.*

*Areas of Agreement and Disagreement. Since the Study Committee was not unanimous on what that revision should be, some background is required. The first question is whether a purchaser from a dealer should be permitted to sue a remote seller, especially a manufacturer, for breach of warranty for nonconformities in the goods at the time they left the seller's possession. Where is the area of disagreement?*

*1. All agree that if the remote seller has made an express warranty through advertising or otherwise to the buyer that became part of the basis of the buyer's bargain with its seller, a suit against the remote seller should be allowed. Consistent with our recommendations regarding § 2-313, the remote seller should be permitted to show that the representations did not in fact become part of the buyer's bargain.*

*2. All agree that if the goods are otherwise merchantable but do not satisfy the buyer's particular purposes, the requirements of § 2-315 must be met. The effect of this is to require privity of contract. Where a buyer has special needs and the goods are complex, one would expect direct bargaining (or a sufficient nexus between the parties) before the seller is required to assume the risk that the goods do not satisfy the buyer's needs.*

*3. The main area of disagreement arises when the goods are unmerchantable at the time they leave the remote seller's possession and there are no express warranties as such. Yet even here the buyer makes a decision based upon product description, price and the ordinary uses for goods of that type. Should privity be required here?*

*One point of view was that privity should be a defense in this situation. If this view were accepted by the Drafting Committee, the following revision of § 2-318 might be warranted:*

*Regardless of the nature of the loss (and subject to the possibility that there may be a true third party beneficiary contract), the general rule is that there shall be no recovery for breach of warranty unless there is privity of contract between the seller and buyer. This rule applies whether the plaintiff is a commercial or consumer buyer.*

*There are two exceptions:*

*(1) Where the plaintiff is an assignee of a warranty made by the seller to the plaintiff's assignor; and*

*(2) Where the seller's express warranties have become part of the buyer's bargain with its seller.*

*In addition, under the revised § 2-318 the court should have power to define what amounts to privity but not to dispense with the requirement where privity is not present. Finally, a remote seller should be able to exclude or limit liability to its dealer through an appropriate clause, regardless of the type of injury suffered by the ultimate purchaser.*

*Another point of view claims that the privity requirement imposes unrealistic and unfair limitations upon a manufacturer's responsibility for unmerchantable goods. When these limitations are combined with the judicial refusal to impose tort liability where there is only economic loss, there is less incentive for remote sellers to improve product quality and buyers are left to the vagaries of the contracting process and the risk that their seller will be insolvent or out of business.<sup>44</sup> From this point of view, the privity requirement for breach of the implied warranty of merchantability, therefore, should be deleted from § 2-318.*

## *2. Revisions Needed in Article 2 if Privity is Not Required.*

*Article 2 was not drafted for the case where a buyer is permitted to sue a remote seller for breach of warranty.*

*(B) The Study Group agrees that revisions are required to accommodate the possibility that privity will not be required and has identified eight problem areas where revisions are required. We recommend that the Drafting Committee produce concrete answers to the following questions.*

*1. Should a remote buyer be afforded a right of rejection or revocation as against the remote seller?*

*2. Should a remote buyer be allowed to recover the price it paid for the goods, or should its recovery be limited to the price the remote seller received for the goods?*

*3. How does the Code's notice requirement for breach apply? Must the remote buyer notify the remote seller to preserve its remedies for breach, or is notification to the immediate seller sufficient?*

*4. Is a remote seller afforded a right to cure? Is such a right additional to the immediate seller's right to cure?*

---

<sup>44</sup> This argument is elaborated in Speidel, *Warranty Theory, Economic Loss, and the Privity Requirement: Once More Into the Void*, 67 B.U.L. Rev. 9, 35-57 (1987).

5. May a seller in its contract with its own buyer prevent assignability, thereby limiting any warranties solely to its own buyer?

6. In the absence of an enforceable disclaimer or limitation of consequential damages, may a remote buyer recover consequentials such as lost profit from a remote seller?

7. May a remote buyer sue for breach of an express warranty on which there is no reliance?

8. What is the effect of a disclaimer in the contract between remote seller and its buyer on the suit by remote buyer against remote seller?

(C) The Study Group agreed that persons permitted to assert breach of warranty claims under Article 2 should be limited to buyers. § 2-103(1)(a). A remote seller's warranties, therefore, do not extend to persons in the household of the buyer or "any person who may reasonably be expected to use, consumer or be affected by the goods."<sup>45</sup>

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-319]

U. F.O.B. AND F.A.S. TERMS: § 2-319.

FOB terms perform three important functions. They: (1) Impose an obligation to ship the goods on the seller; (2) Define what the seller must do to tender delivery, §§ 2-503 & 2-504; and (3) Determine when, in the absence of breach, risk of loss passes to the buyer. § 2-509(1).<sup>46</sup> When the term is clearly expressed as either "FOB the place of shipment" or "FOB the place of destination," the different effects on tender of delivery and risk of loss are carefully spelled out in Article 2. A problem in interpretation may arise, however, if the FOB term is used without a clear designation of "a named place." If the FOB is equivocal and there is no other agreement to the contrary, the courts have presumed that an "FOB place of shipment" contract was intended.<sup>47</sup>

Rec. A2.3 (16).

The Study Group recommends that a new § 2-319(1)(d) be drafted to express the presumption favoring "FOB the place of shipment" in the text of the statute.

---

45. Thus, if a non-buyer's claim in tort is barred by the tort statute of limitations but not the "warranty" statute of limitations, § 2-725, that plaintiff would not be able to bring a warranty claim under Article 2.

46. In addition, delivery terms determine when title passes to the buyer. § 2-401(2). See *Crocker Nat. Bank v. Ideco Division of Dresser Industries*, 839 F.2d 1104 (5th Cir. 1988)(under FOB place of shipment term, title did not pass until goods delivered to carrier).

47. See Comment 5 to § 2-503 and the cases collected in Par. 2319.1 and par. 2319.10, of Callaghan's UCC Case Digest.

*Although no further revisions are recommended, the use of a "F.A.S." term indicates that an international sale may be involved. Accordingly, the Drafting Committee should review the relevant provisions of the Convention on Contracts for the International Sale of Goods, the INCO Terms and other relevant International Conventions to insure a proper mesh.<sup>48</sup>*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-320]

V. C.I.F. AND C. & F. TERMS: § 2-320.

*No revisions in the text of § 2-320 are recommended.*

*Section 2-320(1) defines the pricing implications of using the terms C.I.F. and C.&F. and § 2-320(2) states the seller's delivery obligations when the term "C.I.F. destination or its equivalent" is used. Section 2-320(3) draws an important distinction between the effect of C.I.F. and C.&F. terms (the insurance obligation) and § 2-320(4), like § 2-319(4), requires the buyer to make payment against documents. Comments 1 and 14 to § 2-320 state that the C.I.F. term "indicates a contract for proper shipment rather than one for delivery at destination." Thus, the risk of loss passes at the point where the seller satisfies the obligations under § 2-320 rather than when the goods actually arrive at the destination.*

*This result may be clear from the comments and in the trade, but it is not so obvious from the text of § 2-320(2). For example, § 2-320(2) uses the term "C.I.F. destination" intending a "place of shipment" result while the term "F.O.B. the point of destination" under § 2-319(1)(b) would defer the risk of loss until the goods actually arrive.*

*Rec. A2.3 (17).*

*The Study Group recommends that the Drafting Committee consider whether additional clarity is required in the text of § 2-320(2).*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-321]

W. C.I.F. OR C. & F.: "NET LANDED WEIGHTS";  
"PAYMENT ON ARRIVAL"; WARRANTY OF CONDITION  
ON ARRIVAL: § 2-321.

*Except for ensuring a proper mesh with the law of international sales, no revisions are recommended in § 2-321.*

---

<sup>48</sup>. An excellent starting point for the review is Berman, *The Law of International Commercial Transactions*, 2 *Emory J. Int'l Dispute Resolution* 235 (1988).

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-322]

*X. DELIVERY "EX-SHIP": § 2-322.*

*Except for ensuring a proper mesh with the law of international sales, no revisions are recommended in § 2-322.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - § 2-323]

*Y. FORM OF BILL OF LADING REQUIRED IN OVERSEAS SHIPMENT; "OVERSEAS": § 2-323.*

*Except for ensuring a proper mesh with the law of international sales, no revisions are recommended in § 2-323.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-324]

*Z. "NO ARRIVAL, NO SALE" TERM: § 2-324.*

*Except for ensuring a proper mesh with the law of international sales, no revisions are recommended in § 2-324.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-325]

*AA. "LETTER OF CREDIT" TERM; "CONFIRMED CREDIT": § 2-325.*

*Subject to possible revisions in Article 5 or other sources of letter of credit law, no revisions are recommended in the text of § 2-325.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-326]

*BB. SALE ON APPROVAL AND SALE OR RETURN;  
CONSIGNMENT SALES AND RIGHTS OF CREDITORS:  
§ 2-326.*

*A number of revisions are recommended in the text of § 2-326 and § 9-114.*

### 1. Overview.

Section 2-326 deals with one aspect of the larger problem of ostensible ownership. That larger problem, simply stated, is this: If A delivers goods to B and in that transaction reserves power to retrieve the goods from B at some later time, what are the rights of C, a creditor of B, who knows that B has possession of but does not know of A's interest in the goods? The answer is clear if A and B intended to create a security interest in the goods or A, a seller, retained title to the goods after delivery to B: Article 9 applies and C's rights are determined, in the main, by Article 9. See §§ 1-201(37) & 9-102.<sup>49</sup>

But suppose that Article 9 does not apply? Suppose that A, a bailor, entrusts the goods to B for repair or processing and C relies on that possession. Since a financing transaction was not intended, C assumes the risk that B does not own the property despite the apparent ownership. This follows even though B is a merchant who deals in goods of that kind.

A similar problem arises when a seller delivers goods to a buyer "on approval" or on "sale or return" or an owner consigns goods to a consignee with power to resell. Since a secured transaction is not involved, Article 9 does not apply. Section 2-326, however, was drafted with the interests of C, a creditor of the party in possession, in mind.<sup>50</sup>

### 2. Current Problems and Solutions.

After delivery of goods under transactions characterized as a sale on approval or a sale or return or a "true" consignment, what are the rights of creditors of the party in possession against the seller or consignor to whom, under the terms of their contracts, the goods may be returned? Suppose the creditor obtains a judicial lien on or a perfected security interest in the goods? Can the seller or consignor retrieve the goods free of that lien or security interest?

The current answers under § 2-326 are:

(1) Goods held on approval are "not subject to the claims of the buyer's creditors until acceptance. . .", § 2-326(2);

(2) Goods held on sale or return "are subject to such claims while in the buyer's possession. . . .", § 2-326(2); and

---

49. See Mooney, *The Mystery and Myth of "Ostensible Ownership" and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 Ala. L. Rev. 683 (1988)(exploring history, mystery and myth of "ostensible ownership" doctrine).

50. Conceivably, the so-called "ostensible ownership" problem is no longer a serious risk and the burden should be placed upon the creditor to inquire rather than upon the consignor to disclose. See Revision at 457-58.

(3) Goods, whether or not held under a "true" consignment, "are deemed to be on sale or return" if delivered for sale to a person meeting the conditions stated in § 2-326(3), i.e., a person who "maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making the delivery." The consignor, however, can avoid the "deemed" sale or return rule by satisfying one of the three methods of giving public notice spelled out in § 2-326. If the option to comply with the filing provisions of Article 9, § 2-326(3)(c), is selected, § 9-114 states the conditions under which a consignor whose consignment is "not a security interest" has priority.<sup>51</sup>

### 3. Proposed Revisions.

A number of problems have been identified in and around the current statutory solutions.

#### Rec. A2.3 (18).

In order to simplify and clarify, the Study Group recommends the following revisions in the text of or comments to § 2-326.

(A) Assuming that a consignment for security is governed only by Article 9 and that a "true" bailment is not governed by either Article 2 or Article 9, a "true" consignment should be governed by § 2-326 and, to the extent relevant, the priority rules of Article 9. An effort to distinguish a "true" consignment from a consignment for security should be made in the comments.<sup>52</sup>

(B) § 2-326 should be revised as follows:

(1) The only option for giving public notice should be compliance with the filing provisions of Article 9. Option (a) of § 2-326(3) should be deleted and option (b) should be limited to cases where goods are delivered to an auctioneer for sale.

(2) The phrase "delivered to a person for sale" in § 2-326(3) should be expanded to include all deliveries of goods pursuant to which the parties expect the consignee ultimately to sell to others, even though further processing or prior consent to sale is required.

(3) Clarification of whether the consignee must, as § 2-326(3) now provides, "maintain a place of business at which he deals in goods of the kind involved" should be made. As written, this restricts

---

51. Under § 2-326(3), if a consignor does not file a financing statement but complies with either of the notice alternatives in (a) or (b), § 9-114 should not apply.

52. The Study Group agreed that a "sale or return" and a "true" consignment should be governed by the same rules where third parties asserted claims to the goods. Both are non-security consignments for sale.



*the scope of protection to third parties. Section 2-326(3) should also be broadened to include delivery to and possession by a "merchant who deals in goods of that kind." Compare § 2-403(2).*

*(4) Consignors who are "consumers" should be excluded from the public notice requirements of § 2-326(3).<sup>53</sup>*

*(5) A Seller (as well as a consignor) who delivers on "sale or return" should not be subject to the claims of the buyer's creditors if the seller gives public notice by filing a financing statement.*

*(C) The Study Group recommends that the Article 9 Study Committee consider the following revisions to § 9-114 and, where appropriate, to other sections of Article 9.*

*(1) If a consignor has filed a proper financing statement but has not met the additional conditions in § 9-114(1), the priority provisions of § 9-312(5) rather than § 9-114(2) should control. The consignor should not be automatically subordinated.*

*(2) It should be made clear that priority between a lien creditor and a consignor who files but does not meet the conditions in § 9-114(1) should track the priority rules in § 9-301(1)(b).*

*(3) It should be made clear that a consignor's interest in the goods attaches to their proceeds and what the priority of the consignor's interest should be.*

*The Study Group agreed that the further implications of Article 9 on these transactions should be left to the Article 9 Study Committee.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-327]

#### CC. SPECIAL INCIDENTS OF SALE ON APPROVAL AND SALE OR RETURN: § 2-327.

*No revisions are recommended in the text of § 2-327.*

*The terms "sale on approval" and "sale or return" are defined in § 2-326(1) and the special incidents of each between the parties are spelled out in § 2-327. No problems of consequence have arisen in the interpretation of § 2-327.*

*The risk of loss issues will be discussed under § 2-509, infra.*

---

<sup>53</sup> See Dolan, *The UCC's Consignment Rule Needs an Exception for Consumers*, 44 Ohio St. L.J. 21 (1983).

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-328]

DD. SALE BY AUCTION: § 2-328.

*No revisions are recommended in the text of § 2-328.*

*An auction is a technique employed by an auctioneer, usually the agent of the seller, to generate competitive offers for the goods. Auctions and auctioneers may be regulated by special legislation. Also, the conditions of the auction and the terms of any resulting contract may be determined by the seller, if such conditions and terms are communicated to prospective bidders in advance. Section 2-328 provides a few special rules that apply, primarily, to disputes over when the sale was complete and the effect of putting up the goods "without reserve."*

*Although a thorough investigation has not been done, no problems of consequence appear to have arisen in the operation or interpretation of § 2-328.<sup>54</sup>*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-401]

#### ARTICLE 2, PART 4:

#### TITLE, CREDITORS AND GOOD FAITH PURCHASERS

A. PASSING OF TITLE; RESERVATION FOR SECURITY;  
LIMITED APPLICATION OF THIS SECTION: § 2-401.

*No revisions are recommended in § 2-401.*

*The rejection in § 2-401 of "title" as a problem solving device was a major innovation in Article 2. Neither risk of loss nor liability for the price now depend upon who has title to the goods. Experience has vindicated Llewellyn's judgment that the elimination of title was a "true contribution and a true opportunity to bring a difficult, useful and troubled body of law within the compass of anybody, anytime, anyhow."*

---

54. But see Revision at 408-10 (questioning whether an auctioneer should be treated as a seller for warranty purposes). See also, Kershen, *Horse-Trading: Legal Implications of Livestock Auction Bidding Practices*, 37 Ark. L. Rev. 119 (1983).

1. Llewellyn, *Hearings Before the New York Law Revision Commission on the Uniform Commercial Code 96-97* (1954). Professor Williston, of course, was highly critical of this move. See Williston, *The Law of Sales in the Proposed UCC*, 63 Harv. L. Rev. 561, 566-71 (1950).

*Although the carefully hedged and neutral "title" principles in § 2-401(1) have frequently been invoked in litigation, no major problems have arisen in their interpretation and application. Section 2-401 has simply been one ingredient in disputes that are frequently resolved under other sections of Article 2, e.g., § 2-403.*

*The principles of § 2-401 may be preempted by other state or federal legislation dealing with sales, such as the Certificate of Title Acts or farm legislation. A survey of this legislation in the comments may be useful. Also, § 2-401 may be relevant to non-sales disputes, such as the applicability of state and local tax legislation.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-402]

**B. RIGHTS OF SELLER'S CREDITORS AGAINST SOLD GOODS: § 2-402.**

**Rec. A2.4 (1).**

*Minor revisions are recommended in § 2-402.*

*Section 2-402(1), amplified, deals with priority disputes between "unsecured creditors" of the seller and buyers over "identified goods" in the seller's possession. Subject to §§ 2-402(2) & (3), the rights of these unsecured creditors are determined outside of Article 2 but are "subject to" the buyer's possessory rights under §§ 2-502 and 2-716.*

*(A) If § 2-502 is deleted, as recommended by the Study Group, § 2-402(1) should be revised to reflect this change.<sup>2</sup>*

*The balance struck in § 2-402(2) between state fraudulent conveyance law and "good faith" retention by a merchant seller has produced little litigation and no apparent problems.<sup>3</sup> The same can be said about § 2-402(3)(b), dealing with the rights of creditors of the seller where retention of delivery "is made not in current course of trade. . . ."*

*In light of recommendations for the revision of § 2-403, infra, § 2-402(3)(a) may state too broad a proposition. A BIOCB under § 2-403(2) may, under certain circumstances, cut off a security interest created under Article 9, even though § 9-307(1) does not apply.*

---

2. A more general question is whether the buyer's possessory rights under Article 2 are broad enough? As now drafted and interpreted by the courts, § 2-716 does not provide much protection to the buyer.

3. A leading case interpreting § 2-402 is *In re Black & White Cattle Co.*, 783 F.2d 1454 (9th Cir. 1986).

*(B) If § 2-403 is so revised, we recommend that § 2-402(1) be revised to state "Except as provided in § 2-403, nothing in this Article. . . ."*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-403]

**C. POWER TO TRANSFER; GOOD FAITH PURCHASE OF GOODS; "ENTRUSTING": § 2-403.**

*Section 2-403 has been the subject of considerable litigation and law review commentary.<sup>4</sup> In light of some history under § 2-403, we recommend the following revisions, as discussed below.*

**Rec. A2.4 (2)**

**1. § 2-403(1).**

*(A) In § 2-403(1), the principle of Nemo Dat Quod Non Habet (One who hath not cannot give) should be made explicit. Also, the word "rights" should be combined with "and title" in the first sentence. The overall revision might read: "A purchaser of goods acquires at least as great but no greater rights and title than his transferor had or had power to transfer.<sup>5</sup> A purchaser of a limited interest acquires rights and title only to the extent of the interest purchased."*

*§ 2-403(1) also confirms the power of a person with "voidable" title to transfer "good" title, but does not say when there is voidable title. At common law, there was disagreement whether the four transfers identified in § 2-403(1)(a) through (d) were within the voidable title rule. A proper reading is that the four transfers expand rather than limit the common law concept of voidable title.*

---

4. E.g., Levmore, *Variety and Uniformity in the Treatment of Good Faith Purchaser*, 16 J. Legal Stud. 43 (1987); Frisch, *Buyer Status Under the UCC: A Suggested Temporal Definition*, 72 Iowa L. Rev. 531 (1987); Leary & Sperling, *The Outer Limits of Entrusting*, 35 Ark. L. Rev. 50 (1981); Weinberg, *Sales Law, Economics, and the Negotiability of Goods*, 9 J. Legal Stud. 569 (1980); Warren, *Cutting Off Claims of Ownership under the UCC*, 30 U. Chi. L. Rev. 469 (1963). See also, Gilmore, *The Commercial Doctrine of Good Faith Purchaser*, 62 Yale L.J. 1057 (1954).

5. See § 8-301(1), which provides that upon "transfer of a security to a purchaser. . . , the purchaser acquires the rights in the security which his transferor had or had actual authority to convey. . . ." This revision of § 2-403(1) operates as a limitation on other sections where the power to transfer is defined. See, e.g., §§ 9-301(1) & 9-307(1).

**(B) This interpretation should be made clear in a comment.<sup>6</sup>**

*There is some support for the view that a buyer who knows or has reason to know of competing third party claims to the goods is per se in bad faith.*

**(C) The Study Committee rejects a per se test and recommends that the comments be revised to state that whether a buyer is in good faith depends upon the facts and circumstances of each case.**

**2. § 2-403(2).**

*Section 2-403(2) gives a merchant to whom goods have been entrusted "power to transfer all rights of the entruster to a buyer in the ordinary course of business." A recurring question is whether the BIOCB (no matter how defined) "takes free" from a security interest held by the entruster if § 9-307(1) is not satisfied, i.e., the security interest was not created by "his seller," the merchant. Some courts have read § 2-402(3)(a) and § 2-403(4) to mean that § 9-307(1) controls and the BIOCB is not protected.<sup>7</sup>*

**(D) The Study Committee recommends a revision that insures protection of the BIOCB under § 2-403(2) if the secured party itself has entrusted the goods to a merchant, even though the security interest was created by another party.<sup>8</sup> Further, it should be made clear that if the goods are entrusted to Merchant #1, who sells to non-BIOCB Merchant #2, who sells to BIOCB, the BIOCB takes "all rights" or takes "free" of a security interest. Finally, it should be made clear that the "shelter" principle operates where there is a break in the chain of merchants. Thus, a BIOCB takes the rights of a person who entrusted the goods to a merchant who resold them to a non-BIOCB who sold them to the BIOCB.**

*Any revision of § 2-403 must be coordinated with the revised definition of buyer in the ordinary course of business and other changes in sections dealing with the rights of third parties. See Rec. A1(4).*

---

6. The phrase "transaction of purchase" in § 2-403(1) is broader than the phrase "contract for sale." Yet the phrase "voidable title" suggests that the purchaser who has power to transfer good title is in possession of the goods under a voidable transaction of "sale." If so, the language of § 2-403(1) should be sharpened to reflect this.

7. *Contra: Executive Financial Services, Inc. v. Pagel*, 238 Kan. 809, 715 P.2d 381 (1986).

8. Entrustment, in general, might occur if the secured party delivered goods in its possession to, or acquiesced in the debtor's delivery to the merchant. See § 2-403(3). Some members of the Study Group disagrees that the broad reading of entrustment should apply here.

## [TASK FORCE - 2-403]

## ARTICLE 2 - PART 4

## SECTION 2-403

Conventional wisdom emphasizes the sanctity of the good faith purchase doctrine, a partial expression of which is found in section 2-403. Notwithstanding the grip that this doctrine presently has on our collective psyche, now may be the time to seriously rethink its future. Recall that it was not too long ago that Grant Gilmore fancifully labelled the Code's treatment of third party rights as "a mid-twentieth-century codification of a mid-nineteenth-century idea whose time has long since gone."<sup>255</sup> At a minimum, greater attention to the substance of section 2-403 is necessary.

Section 2-403(1) begins with the statement that a purchaser acquires all of the title that his transferor had or had power to transfer.<sup>256</sup> The Task Force agrees with the Study Group that the concept of "title" should be explicitly expanded to include "rights," but it believes that the overall revision of the sentence suggested by the Study Group is without consequence and unnecessary.

The remainder of subsection (1) empowers a person with voidable title to transfer a good title to a good faith purchaser for value.<sup>257</sup> One may wonder why such a purchaser is deserving of protection. Notice that no policy statement is provided to explain the subsection as written. If the voidable title provision is premised on the need to protect the interest of third parties who rely on the transferor's good title, it goes too far, yet, at the same time, not far enough. Because of the broad definition of the terms "purchaser"<sup>258</sup> and "value,"<sup>259</sup> the protected class will include secured parties who were in no way misled by the voidable title

---

255 Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA L. REV. 605, 605-06 (1981).

256 See U.C.C. § 2-403(1) (1990).

257 See *id.*

258 See U.C.C. § 1-201(33) (1990) (defining purchaser as anyone who takes "by sale, discount . . . pledge, lien . . . or any other voluntary transaction creating an interest in property").

259 See U.C.C. § 1-201(44) (1990) (stating a broad definition of value).

holder's possession.<sup>260</sup> On the other hand, many who do rely on possession will find themselves unprotected in situations where their transferor was found to be without voidable title<sup>261</sup> or, as in the case of a judicial lien creditor who does rely on possession,<sup>262</sup> because they do not take by purchase.

Subsections (2) and (3) also lack a single explanatory policy statement. Why is it just the BIOCB who is protected and not other purchasers for value? If the purpose of the entrustment doctrine is to protect reasonable reliance, should not the scope of the protected class be the same as that under subsection (1)? Furthermore, why not go all the way and make goods fully negotiable? As things now stand, a BIOCB is protected despite the fact that the entrustment was the product of larceny.<sup>263</sup> Why is the BIOCB not equally deserving of protection if the true owner was deprived of possession by a thief who then entrusted to a merchant? Certainly the Study Group's recommendation to extend the protection of section 2-403(2) to BIOCBs who do not qualify for protection under section 9-307(1) is a step in the right direction.

It is the opinion of the Task Force that section 2-403 raises a number of issues which require further study.<sup>264</sup> The Task Force believes that there are instances in which the true owner should be estopped to contest the transfer of ownership to another and

2

---

260 Due to an after-acquired property clause in the security agreement and prior extensions of credit, a secured party will attain the status of a good faith purchaser for value even if it has knowledge of a third party claim to the goods and it makes no further advances after the debtor receives possession. *See In re Samuels & Co.*, 510 F.2d 139, 155 (5th Cir. 1975), *rev'd on rehearing en banc*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976) (stating that Article 2 good faith only requires honesty in fact, reasonable commercial behavior, and fair dealing).

261 Such would be the case if, for example, the transferor was a mere bailee or if it had received its possession from a thief.

262 The possibility that a judicial lien creditor will rely on its debtor's possession is implicitly recognized by those recording acts which protect such creditors against prior unrecorded conveyances. *See, e.g.*, U.C.C. § 9-301 (1990); ILL. ANN. STAT. ch. 30, § 39 (Smith-Hurd 1969); MINN. STAT. ANN. § 507.34 (West 1986); N.J. STAT. ANN. § 46:22-1 (West 1989).

263 U.C.C. § 2-403(3) (1990).

264 The Drafting Committee should also consider ways to ease the tension between U.C.C. § 2-403 and the array of statutes regulating the sale of many types of personalty. In particular, motor vehicles have been the source of frequent litigation. *See generally* Kunz, *Motor Vehicle Ownership Disputes Involving Certificate-of-Title Acts and Article Two of the U.C.C.*, 39 BUS. LAW. 1599 (1984) (detailing the many types of disputes arising due to the clash of the U.C.C. and Title Certificate Acts).

that section 2-403 could possibly be rewritten to capture these instances with a greater degree of precision. Perhaps all that is necessary is an explicit recognition of the applicability of the doctrine of estoppel, which is presently implicit in the subsection (1) phrase "or had power to transfer."<sup>265</sup>

It is also the opinion of the Task Force that disputes involving secured parties are better left to Article 9. Presumably, the drafters enacted section 9-307 for a reason.<sup>266</sup> If that section is now deemed inadequate, it is wise and desirable to redraft it directly, not indirectly through Article 2. To do otherwise risks compromising the internal structure and harmony of Article 9.

*[PRELIMINARY REPORT - 2-501]*

**ARTICLE 2, PART 5:  
PERFORMANCE**

**A. INTRODUCTION.**

*Article 2, Part 5 contains 15 sections dealing with "performance" of the contract for sale, including §§ 2-509 and 2-510 which cover risk of loss. We will discuss each of these sections seriatim.*

**B. INSURABLE INTEREST IN GOODS; MANNER OF IDENTIFICATION OF GOODS: § 2-501.**

**Rec. A2.5 (1).**

*No revisions are recommended in the text of § 2-501. Some clarifying revisions in the comments are suggested.*

*The time when "existing" goods are identified to the contract is determined under § 2-501(1). As with title, § 2-401, identification can be made by explicit agreement or, in the absence of agreement, under the rules in § 2-501(1). Upon identification, the buyer obtains both "a special property interest and an insurable interest" in the goods. No serious problems have arisen in the judicial determination of whether identification has occurred.*

*One consequence of identification is that the buyer has a "special property" interest in the goods. This interest enhances the buyer's rights and*

---

<sup>265</sup> U.C.C. § 2-403(1) (1990).

<sup>266</sup> Section 9-307 is Article 9's way of internally dealing with buyers of goods in the ordinary course of business. See U.C.C. § 9-307 (1990).



*remedies under the provisions of Article 2, especially where it permits the buyer to take possession of the goods.<sup>1</sup>*

*(A) For clarity, we recommend that all references in Article 2 to "identification" and its effect be collected in a new Comment to § 2-501.*

*Another consequence of identification is that the buyer has an "insurable interest" in the goods. Article 2 does not deal explicitly with insurance, although its availability is assumed in the risk of loss sections.*

*(B) The Study Group endorses the expandable notion of insurable interest in § 2-501(3) and would purge from the comments any suggestion that the insurable interests described in § 2-502(2) limit the general scope of that concept.*

[TASK FORCE - 2-501]

## ARTICLE 2 - PART 5

### SECTION 2-501

The Task Force agrees with the Study Group's recommendation that all references to "identification" in Article 2 be collected in a new comment to section 2-501.

This useful cross-reference would be helpful because the concept of "identification," although independently insignificant, becomes significant through the application of various Code sections.<sup>266</sup> In particular, identification signifies the moment when the buyer acquires a "special property" interest in the goods.<sup>267</sup> This is the conceptual springboard that takes the buyer from a mere expectation of receiving conforming goods to a cognizable interest in particular goods.<sup>268</sup>

[PRELIMINARY REPORT - 2-502]

### C. BUYER'S RIGHT TO GOODS ON SELLER'S INSOLVENCY: § 2-502.

*Rec. A2.5 (2).*

*(A) The Study Committee recommends that § 2-502 be deleted.*

---

1. See *Daniel v. Bank of Hayward*, 144 Wis.2d 931, 425 N.W.2d 416 (1988)(holding that the buyer became a BIOC at the time of identification).

266 See, e.g., U.C.C. §§ 2-401(1), 2-502 & 2-716(3) (1990) (each of these Code sections is based upon the concept of identification).

267 See U.C.C. § 2-501(1) (1990).

268 See U.C.C. §§ 2-105(2), 2-501(1) (1990).

*Section 2-502 is the buyer's counterpart to the seller's reclamation right under § 2-702(2). Limitations upon its application (goods must be identified, buyer must have advanced all or part of the price and rights terminate 10 days "after receipt of the first installment on their price") and doubts about its enforceability in bankruptcy<sup>2</sup> prompt the recommendation to delete.*

*Even with § 2-502, the rights of the pre-paying or financing buyer of goods are quite limited under Article 2. The question is whether adequate protection against the seller and creditors of the seller should be obtained by revisions in Article 2 or by revisions in Article 9.*

*(B) The Drafting Committee recommends that Article 9 rather than Article 2 be revised to provide adequate protection to the pre-paying or financing buyer.*

[TASK FORCE - 2-502]

## SECTION 2-502

Most members of the Task Force agree with the Study Group's recommendation to delete section 2-502. The potential bankruptcy problem (it raises both a statutory lien<sup>270</sup> as well as a voidable preference<sup>271</sup> problem) is substantial, given the fact that the seller's default, upon which the buyer's right to seller's property under this section depends, will most likely be the seller's bankruptcy.

Further, the recommendation that Article 9, and not Article 2, should be the proper vehicle for solving this problem would appear to be correct because the problem is not one of sales, but one of security. Under this section, the buyer is asserting a right to property of the seller that probably is subject to competing creditors' claims.<sup>272</sup> The priority of the buyer's claim as against either the seller or the seller's other creditors is a question that in any other context would be resolved through the structure of Article 9.

There is, therefore, some concern on the Task Force that a gap will exist in the scope of the buyer's protection until a corresponding change is made in Article 9. Thus, at least one member does not support deletion of section 2-502 until a revision of Article 9 is drafted.

---

2. See Levy, *Impact of the New Bankruptcy Code on Article 2, Sales*, 14 U.C.C. L.J. 307, 336-38 (1982)(trustee as creditor of seller could avoid reclamation claim).

270 11 U.S.C. § 545 (1984).

271 11 U.S.C. § 547 (1986).

272 U.C.C. § 2-502 (1990).

*[PRELIMINARY REPORT - 2-503]***D. MANNER OF SELLER'S TENDER OF DELIVERY:  
§ 2-503.*****Rec. A2.5 (3).***

*Minor revisions are recommended in the text of and comments to § 2-503.*

*Section 2-503 is an important and complex provision. Without a proper tender of delivery, the buyer has no duty to accept and pay for the goods. § 2-507(1). In addition, an improper tender may permit the buyer to reject the goods or delay passage of the risk of loss. Clarity and commercial reasonableness in these provisions, therefore, are important.<sup>3</sup>*

*No serious problems have emerged in the interpretation and application of § 2-503 by the courts. Some minor issues have arisen, however, and clarifications are required.*

*1. Without FOB terms in the agreement, § 2-319(1), it is not clear when a seller who is authorized to ship the goods is "required to deliver at a particular destination." § 2-503(3). Comment 5 to § 2-503 provides a rule for construction, i.e., that the FOB shipment contract is regarded as normal.<sup>4</sup>*

*(A) We reiterate our recommendation [see A2.3(1)], that this rule of construction be placed in the text of either § 2-319(1) or § 2-503.*

*2. In § 2-503(4), the term "bailee" is not defined. This has caused some confusion in risk of loss cases. In § 2-504(4)(a), it is not stated to whom the bailee's acknowledgment must be made, the seller or the buyer. This same omission appears in § 2-509(2)(b), and has produced at least one major law suit.<sup>5</sup>*

*(B) We recommend that the Drafting Committee prepare a definition of "bailee" for purposes of § 2-503, with appropriate variations for risk of loss issues. In addition, we recommend that § 2-503(4)(b) and § 2-509(2)(b) be revised to state that the bailee's acknowledgment must be "to the buyer." Neither section makes sense unless the buyer knows of the acknowledgment.*

---

<sup>3</sup> The statute of limitations begins to run at the time of tender of delivery, even though the tender is improper. § 2-725(1).

<sup>4</sup> *Accord, Ladex Corp. v. Transportes Aereos Nacionales, S.A.*, 476 So.2d 763 (Fla. App. 1985).

<sup>5</sup> *Jason's Foods, Inc. v. Peter Eckrich & Sons, Inc.*, 774 F.2d 214 (7th Cir. 1985)(interpreting § 2-509(2)(b) to require an acknowledgment to the buyer).

3. Section 2-503(5) applies when the "contract requires the seller to deliver documents. . . ."

*(C) The Study Group recommends, at the maximum, that all Article 2 sections dealing with documentary transactions be integrated in a separate Part to Article 2. At the minimum, all sections dealing with documentary transactions should be organized in a single new comment to § 2-503. Clear and complete cross references to Article 7 should also be included.*

[TASK FORCE - 2-503]

## SECTION 2-503

Comment 5 of section 2-503 states that, unless otherwise denoted, a contract in which the goods are to be shipped is presumed to be a shipment contract and not a "destination" contract. The fact that this rule of construction is in the comments and not the text has not been a problem as far as interpretation is concerned. This result is, therefore, generally assumed to be the case. However, moving this rule from the comments to the Code will eliminate any argument about the validity of this comment as authority. This recommendation by the Study Group is more of a technical correction than a substantive change and, therefore, should not cause any concern.

The Task Force supports the recommendation to define "bailee" within Article 2 for the purposes of section 2-503 and other relevant sections. The lack of a definition of bailee has caused some confusion in the risk of loss cases. Normally, "bailee" signifies a professional bailee such as a warehouseman, as is the case under Article 7.<sup>273</sup> Because Article 2 does not define "bailee," however, a broader definition is possible. The concern is whether the seller can claim status as a bailee. The Report, without indicating its content, merely suggests that a definition is needed. It would appear advisable to adopt the Article 7 definition of "bailee" because a broader definition, which would include the seller of goods, would pose definite problems such as those encountered in interpreting the risk of loss rules.<sup>274</sup>

---

273 For purposes of Article 7, "bailee" is defined as a "person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them." U.C.C. § 7-102(1)(a) (1990).

274 Under § 2-509(3), the general rule is that a merchant seller retains

The Task Force also agrees with the recommendation that sections 2-503(4)(b) and 2-509(2)(b) be revised to state that the bailee's acknowledgment must be "to the buyer." Both of these sections require "acknowledgment by the bailee of the buyer's right . . . ."<sup>275</sup> These sections do not state, however, to whom the bailee is to make this acknowledgment. The answer is clear that acknowledgment is to be made to the buyer; neither of these sections makes any sense otherwise. The failure of the Code to explicitly state this, though, has produced at least one major case.<sup>276</sup> This recommendation will not change the Code as it is presently intended to operate, but will merely clarify an existing ambiguity.

*[PRELIMINARY REPORT - 2-504]*

*E. SHIPMENT BY SELLER: § 2-504.*

*No revisions are recommended in the text of § 2-504.*

*Section 2-504 states what the seller must do to tender delivery in an FOB point of shipment contract. See § 2-319(1)(a) & 2-503(2). The last sentence, however, imposes a limitation upon the remedy of rejection under § 2-601: Certain failures in the tender are "a ground for rejection only if material delay or loss ensues." This limitation will be discussed, infra at Rec. A2(6)(1).*

*[TASK FORCE - NONE]*

*[PRELIMINARY REPORT - 2-505]*

*F. SELLER'S SHIPMENT UNDER RESERVATION: § 2-505.*

*No revisions are recommended in the text of § 2-505.*

*The effect of the seller's conduct under § 2-505(1) is clearly stated. There has been no litigation of significance under this subsection and there is no evidence of problems in the field.*

---

the risk of loss until the buyer receives the goods. The reason for this rule is that the seller will generally be the party with insurance. By allowing the seller of the goods who is not a commercial bailee to assume that status, the risk will prematurely pass to the buyer once the buyer's right to the goods are acknowledged.

<sup>275</sup> This is required under U.C.C. § 2-503(4)(a) (1990) for tender, and under U.C.C. § 2-509(2)(b) (1990) for passage of the risk of loss.

<sup>276</sup> *Jason's Foods, Inc. v. Peter Eckrich & Sons, Inc.*, 774 F.2d 214 (7th Cir. 1985).

§ 2-505(2) clarifies the effect of a shipment under reservation that was in violation of the contract for sale. See § 2-513(3). No problems of substance have arisen under this section.

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-506]

G. *RIGHTS OF FINANCING AGENCY: § 2-506.*

*No revisions are recommended in the text of § 2-506.*

*“Financing agency” is defined in § 2-104(2). No action is required here.<sup>6</sup>*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-507]

H. *EFFECT OF SELLER’S TENDER: DELIVERY ON CONDITION: § 2-507.*

*Rec. A2.5 (4).*

*The Study Group recommends the following revisions in § 2-507.*

1. *§ 2-507(1).*

*Assuming that the required manner of the tender of delivery is established, see § 2-503, § 2-507(1) implements the seller’s general obligation to “transfer and deliver” the goods, § 2-301, by conditioning the buyer’s duty to accept and pay upon tender of delivery by the seller. Section 2-511(1), on the other hand, conditions the seller’s duty to tender upon “tender of payment” by the buyer. If the duties of both the seller and buyer are conditioned upon tender by the other,<sup>7</sup> who tenders first?*

*Where the agreement does not say, Article 2 provides no help. Thus, if neither party tenders delivery, neither party has any duty to complete the exchange.*

---

6. Callaghan’s UCC Case Digest has reported just one case citing § 2-506 since Year One of the Code.

7. See Restatement, 2d Contracts § 233(1), which provides: “Where performances are to be exchanged under an exchange of promises, and the whole of one party’s performance can be rendered at one time, it is due at one time, unless the language or the circumstances indicate the contrary.”

*(A) To avoid this stalemate, the Study Group recommends that § 2-507(1) be revised to state that, unless otherwise agreed, the seller has the duty to tender delivery first, but no duty to deliver the goods until the buyer has tendered payment. Thus, the seller would breach if it failed to tender delivery at the time when performance was due.<sup>8</sup>*

2. § 2-507(2).

*Section 2-507(2), combined with § 2-511(3), has been interpreted to support the common law "cash sale" exception to the general proposition that an unsecured seller cannot reclaim goods delivered to a buyer: If the seller delivers to the buyer in exchange for a check that is dishonored, the seller may reclaim the goods from the buyer.<sup>9</sup> Where dishonored checks are involved, the reclamation right against the buyer is clearly subject to the rights of a good faith purchasers for value under § 2-403(1)(b). The rights in other cash transactions against other creditors and purchasers, however, are not stated in § 2-507(2). Moreover, Comment 3 (now deleted under PEB Commentary #1) states a somewhat arbitrary ten day limitation on reclamation derived from § 2-702(2), which provides a limited reclamation right where the seller delivers goods to a insolvent buyer in a credit transaction.*

*Uncertainties in the proper scope of the "cash seller" exception and its overlap with the "insolvency" exception in § 2-702(2)<sup>10</sup> suggest that revisions are needed in the relevant Code sections.<sup>11</sup>*

*(B) The Study Group recommends that § 2-507(2) be deleted and the "cash payment" exception be integrated with the "insolvency" exception in § 2-702(2). The structure and content of this integration will be discussed infra at Rec. A2.7(2).*

---

8. Upon tender by the seller, the buyer, unless otherwise agreed, has a right to inspect the goods before the duty to accept and pay arises. § 2-513(1). Imposing on the seller the duty to tender first facilitates the exchange without imposing additional risks upon either party.

9. See *Holiday Rambler Corp. v. First National Bank & Trust Co. of Great Bend Kansas*, 723 F.2d 1449 (10th Cir. 1983).

10. An important difference between the two reclamation rights is their effect in bankruptcy. The "cash seller" does not have the same protection as the "insolvency seller" under § 546(c) of the Bankruptcy Code. See Mann & Phillips, *The Reclaiming Cash Seller and the Bankruptcy Code*, 39 S.W.L.J. 603 (1985).

11. See PEB Commentary #1 on the Uniform Commercial Code (1989)(cash seller's reclamation right should not be barred before non-payment is discovered).

## [TASK FORCE - 2-507]

## SECTION 2-507

The Task Force agrees with the Study Group's recommendation that section 2-507(1) be revised to state that, unless otherwise agreed, the seller has the duty to tender delivery first, but has no duty to deliver the goods until the buyer has tendered payment.

Assuming that the required manner of the tender of delivery is established,<sup>277</sup> section 2-507(1) implements the seller's general obligation to "transfer and deliver" the goods<sup>278</sup> by conditioning the buyer's duty to accept and pay upon the seller's tender of delivery. On the other hand, section 2-511(1) conditions the seller's duty to tender on the "tender of payment" by the buyer. Therefore, no one is obligated to go first. To resolve this stalemate, section 2-507 should be redrafted to provide that, unless otherwise agreed, the seller has the duty to tender delivery first, but has no duty to deliver the goods until the buyer has tendered payment. Imposing on the seller the duty to tender first facilitates the exchange without imposing additional risks on either party because the seller does not have a duty to tender delivery before the contractually agreed upon time. Thus, this suggested revision eliminates a structural problem in the Code without interfering with any substantive rights or duties.

Finally, the Task Force sees no reason why section 2-507(2) should not be deleted and the text integrated into section 2-702(2). These two sections overlap, and it makes sense to consolidate them.

## [PRELIMINARY REPORT - 2-508]

*I. CURE BY SELLER OF IMPROPER TENDER OR DELIVERY; REPLACEMENT: § 2-508.*

*Section 2-508 gives the seller a limited right to "cure" a non-conforming tender rejected by the buyer, whether the buyer likes it or not. Professor Peters called it a "significant" innovation that was "remarkably obscure" and almost "impossible to define."<sup>12</sup> Furthermore, there is no comparable provision for the buyer.<sup>13</sup>*

---

<sup>277</sup> See U.C.C. § 2-503 (1990).

<sup>278</sup> U.C.C. § 2-301 (1990).

<sup>12</sup> Roadmap at 210. For Peters' critique, see *Id.* at 210-15.

<sup>13</sup> Peters notes that §§ 2-511(2) and 2-614(2) provide a "minor analogue" for the buyer. *Id.* at 222, note 73.



Section 2-508(1) defines the scope of "cure" when the "time for performance has not yet expired" and § 2-508(2) deals with other cases. By agreement, the parties may expand or narrow the right to cure. Although § 2-508 assumes a rightful rejection by the buyer, see §§ 2-601 & 2-602(1), the "cure, when properly done, limits the buyer's power to cancel the contract for breach. Section 2-508, therefore, manifests a policy which favors preservation of the contract.<sup>14</sup> In general, the Study Group endorsed and was prepared to expand this policy.

*Rec. A2.5 (5).*

*The Study Group recommends the following revisions in the text of § 2-508.*

1. § 2-508(1).

§ 2-508(1) applies when (a) the buyer has made a "rightful"<sup>15</sup> rejection, see § 2-602(1), (b) the time for performance has not expired, (c) the seller "seasonably" notifies the buyer of the intention to cure, and (d) the seller, "within the contract time," makes a "conforming delivery."

(A) *The Study Group recommends that § 2-508(1) be revised to permit a cure when the buyer has justifiably revoked acceptance under § 2-608, provided that the other conditions in § 2-508(1) are satisfied. There is no good reason for limiting cure to cases of rejection where the "time for performance has not yet expired."*

Section 2-508(1) provides that the seller may cure by making a "conforming delivery." Most agree that this can be done by tendering new or additional goods but, unless otherwise agreed, not by offering only a money allowance. A more controversial question is whether a cure can be effected by repairs that conform the goods to the contract.<sup>16</sup> The Drafting Committee should decide when, if ever, a cure under § 2-508(1) can be done by repairing rather than replacing defective goods.

2. § 2-508(2).

§ 2-508(2) defines the seller's right to cure where the buyer has rightfully rejected a non-conforming tender and the time for performance under the

---

14. See Lawrence, *Cure in Contracts for the Sale of Goods: Looking Beyond § 2-508*, 21 U.C.C. L.J. 291 (1989).

15. The text does not so state, but the context otherwise requires.

16. See, e.g. *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 240 A.2d 195 (Law Div. 1968) (where consumer buys a new car, replacing defective with new transmission not an effective cure).

contract has expired. If the seller "had reasonable grounds to believe" that the tender "would be acceptable with or without money allowance" and "he seasonably notifies the buyer," the seller has a "further reasonable time to make a conforming tender."

(B) Although concluding that the "reasonable grounds" test should be administered in an expansive manner, the Study Group was concerned about the imprecision of the test. Should it apply in cases where the seller is unaware of a nonconformity in the goods?<sup>17</sup> Suppose the tender is rejected for delay. Should the seller still be able to "substitute a conforming tender?" We think the answer to both questions should be yes and recommend that the Drafting Committee revise § 2-508(2) accordingly.

The question of what is a proper cure also arises under § 2-508(2). Does "cure" include repair by the seller of the non-conformity or the grant of a money allowance, as well as the substitution of new, conforming goods? The answer is clearly yes if repair or money allowance are authorized by the agreement between the parties. The answer is less clear where there is no agreement, and there is some dispute in the literature.<sup>18</sup> We recommend that the Drafting Committee resolve this question in a revised § 2-508(2).

The Study Group disagreed on whether a "cure" should be permitted after acceptance and after the time for performance had passed, even though the acceptance had been rightfully revoked under § 2-608(1). Resolution of this issue is left for the Drafting Committee and, in any event, depends upon whether the "perfect" tender rule in § 2-601 is retained or rejected.

### 3. Other issues.

(C) We agreed that under either subsection, the buyer's remedies are suspended after receipt of the seller's timely notice until the seller fails to make a timely and proper cure. Within the scope of § 2-

---

17. See, e.g., *T.W. Oil, Inc. v. Consolidated Edison Co. of New York, Inc.*, 57 N.Y.2d 574, 443 N.E.2d 932 (1982)(cure permitted under § 2-508(2) even though seller unaware of nonconformity).

18. If the buyer has rightfully rejected, why should the seller be able to impose repair or a money adjustment in lieu of different, conforming goods? It is one thing when that type of cure is part of relevant trade usage or practice or otherwise agreed. In the absence of persuasive policy arguments to the contrary, why shouldn't a literal interpretation of the statutory language "to substitute a conforming tender" be given? But see Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the UCC: An Economic Approach*, 91 Harv. L. Rev. 960 (1978).

*508, a rejection or revocation of acceptance can be analogized to a demand for adequate assurance, see § 2-609, which is satisfied by a timely cure.*

*Finally, the scope and content of § 2-508 obviously depend upon any revisions made in the "perfect tender" rule.*

[TASK FORCE - 2-508]

## SECTION 2-508

Virtually all of the difficulties with section 2-508 arise because courts and commentators have failed to grasp the reason for each of its subdivisions.<sup>279</sup> Responsibility for this failure rests squarely on the drafters, for they did not clearly state in the comments what they intended.

Nothing in the drafting history of section 2-508 suggests that it was intended to be a broad dispute resolution mechanism encouraging the parties to compromise in the spirit of preserving the contract. Rather, the section contains two carefully drawn subdivisions, each providing a solution to related, but different problems. The subdivisions are part of the same section because the solution to each problem is similar: cure by the seller.<sup>280</sup> Another common thread between the two subdivisions is that they both regulate the opportunistic merchant buyer, who, because of an unfavorable market shift, seizes upon a defect in the seller's tender to avoid the contract.<sup>281</sup> Furthermore, the rules in section 2-508 were intended to apply only to single delivery (non-installment) contracts.<sup>282</sup> Installment contracts have more lenient cure provisions.<sup>283</sup>

Subdivision 2-508(1) covers the buyer who rejects an early non-conforming tender and then refuses to accept a conforming

---

<sup>279</sup> The intent of the drafters must be understood to properly evaluate a section. This intent is important so that some idea can be gained as to how the section was intended to function, not so that a revision can mechanically follow that intent. With this knowledge, the revisers can then decide what corrective action, if any, is required.

<sup>280</sup> See U.C.C. § 2-508(1), (2) (1990).

<sup>281</sup> See *infra* notes 286-88 and accompanying text.

<sup>282</sup> Comment on Section 7-9 (S101) Breach in Installment Contracts at 2 (1948) in the Llewellyn Papers, file J(IX)(2)(b) (reproduced in App. F).

<sup>283</sup> U.C.C. § 2-612(2) (1990) (using a substantial impairment test). See *infra* text at notes 359-76 (discussing the more lenient cure provisions for installment contracts).

retender within the contract time, on the ground that the contract was repudiated and terminated by the initial non-conforming tender.<sup>284</sup> Subdivision (1) gives the seller the right to make a conforming retender upon notice to the buyer, provided the seller can do so within the contract time for delivery.<sup>285</sup> Llewellyn envisaged that the buyer who would most likely be frustrated by this right to cure would be a buyer who rejected the second tender because of a market shift.<sup>286</sup> In effect, the subdivision disables this buyer from claiming that the early non-conforming tender is a repudiation.

Subdivision 2-508(2) was intended to cover a related abuse by the buyer. This abuse arises in commercial contexts in which there is a pattern of the buyer accepting goods with minor non-conformities in return for a price adjustment.<sup>287</sup> In good times, the buyer takes the goods because he can "move" them. In bad times, the buyer may seize upon the minor non-conformities to reject the goods and terminate, what has become for him, an unprofitable contract. This results in injustice and hardship to a seller who has relied upon the pattern of acceptance with adjustment.<sup>288</sup>

If this pattern has clearly hardened into a trade usage, the seller has the contractual right to rely on the pattern of acceptance with adjustment. If the buyer rejects a tender satisfying that pattern, it has breached the contract.<sup>289</sup> If the pattern is not a trade usage, the existence of the pattern raises a question as to whether it is part of the agreement by course of dealing, or whether it is a waiver of the buyer's right to reject for any non-conformity, that the buyer can revoke by due notice.<sup>290</sup> In case of doubt, Llewellyn

---

284 W. HAWKLAND, *SALES AND BULK SALES* 122 (1958).

285 U.C.C. § 2-508(1) reflects the better pre-code caselaw. See 2 S. WILLISTON, *THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT* 721-22 & 722 n.5 (rev. ed. 1948). The right to cure under § 2-508(1) may be subject to the buyer's right to demand adequate assurance of performance under § 2-609. See *infra* text accompanying notes 320-27.

286 Revised Uniform Sales Act: Second Draft § 42-A, Comment at 185 (Dec. 1941), reprinted in 1 A.L.I. and N.C.C.U.S.L., *Uniform Commercial Code Drafts* 465 (1984).

287 Selected Comments to Uniform Revised Sales Act, General Comment on Parts II and IV: Formation and Construction 14, 18 (1948) in the Llewellyn Papers, file J(IX)(2)(a) [hereafter General Comment] (reproduced in App. A). See also 21 A.L.I. *Proceedings* 71, 179 (1944).

288 21 A.L.I. *Proceedings* 71, 179 (1944). See also 1-1954 New York Law Revision Commission Rep. 124.

289 U.C.C. § 2-508 comment 4 (1990); General Comment, *supra* note 287, at 19.

290 General Comment, *supra* note 287, at 14-15.

avored treating the pattern as a waiver.<sup>291</sup> That approach is reflected in subdivision 2-508(2). Thus, where the seller has relied upon the pattern of acceptance with price adjustment to tender goods that do not strictly comply with the literal terms of the contract, the buyer cannot use the seller's technical non-compliance to reject and avoid the contract. Instead, once he gives notice that he is revoking his waiver (by rejecting the goods), he must give the seller the opportunity to furnish goods that strictly comply.<sup>292</sup>

It was also the intent of the drafters that subdivision 2-508(2) not apply to consumer buyers.<sup>293</sup> Thus, the "shaken faith" doctrine, which largely represents courts' refusals to apply that subdivision to consumer buyers, is consistent with the drafters' intent.

The comments to section 2-508 should be revised to make clear (a) the specific abuses that underlie each subdivision, and (b) subdivision 2-508(2) does not apply to consumer buyers.

#### 1. *Revocation of Acceptance and Right to Cure*

Does the seller have a right to cure under section 2-508 when the buyer initially accepts the goods and then properly revokes its acceptance under section 2-608? This issue arises where the buyer has revoked his acceptance under subdivision 2-608(1)(b) based on a non-conformity not known to him when he accepted.<sup>294</sup> The Task Force believes that the seller should have the right to cure. However, the analysis is not the same for each subdivision of section 2-508.

a. *Subdivision 2-508(1)*. The Study Group recommends that a seller be permitted to cure under subdivision 2-508(1) if the buyer initially accepts and then justifiably revokes acceptance.<sup>295</sup> The Task Force agrees with this result.

---

291 *Id.* See also U.C.C. § 2-208 comment 3 (1990).

292 This approach was consistent with some pre-code caselaw. See 2 WILLISTON, *supra* note 285, at 778 n.4.

293 General Comment, *supra* note 287, at 19. Cf. Draft for a "Uniform Sales Act, 1940," Comment on Section 21 at 25, reprinted in 1. A.L.I. and N.C.C.U.S.L., Uniform Commercial Code Drafts 192 (1984); N.C.C.U.S.L., Consideration in Committee of the Whole of the First Tentative Draft of the Amendments to the Uniform Sales Act 6 (1940), reprinted in N.C.C.U.S.L. Archives Publications, microfiche 32.0-A (Hein, 1983).

294 The other ground for revocation, stated in § 2-608(1)(a), applies only where the seller has failed to cure.

295 Prelim. Rpt., Part 5, Rec. A2.5(5)(A), *supra* p. 1136; *id.*, Part 6, Rec. A2.6(6)(B), *infra* p. 1168.

Initially, one should realize that under subdivision 2-508(1) the issue of whether a seller has a right to cure following revocation is unlikely to arise. In most instances, the time for the seller's performance will have expired by the time the buyer learns of the defect and revokes acceptance, so that cure under subdivision 2-508(1) will not be available to the seller.<sup>296</sup> If the buyer revokes acceptance before the seller's time to perform has expired, however, the Study Group correctly concludes that the seller should have the right to cure within the original time for performance.

Subdivision 2-608(3) implies this result, but it has been ignored by courts. What is needed to effectuate the Study Group's recommendation is not textual amendments, but revisions to the comments to section 2-508 and/or section 2-608 to make it clear that subdivision 2-608(3) permits the seller to cure under subdivision 2-508(1) when the buyer revokes acceptance under subdivision 2-608(1)(b).<sup>297</sup>

b. *Subdivision 2-508(2)*. The Study Group split on the question of whether a seller should have the right to cure under subdivision 2-508(2) when the buyer justifiably revokes acceptance. The Task Force believes that the seller should have such a right to cure if he satisfies the requirements of that subdivision.

The issue of cure under subdivision 2-508(2) can arise when the buyer has properly revoked acceptance because the tests for the buyer's right to revoke and the seller's right to cure, are dissimilar. The test for right to cure under subdivision 2-508(2) focuses on what the seller had reason to know, while the test for revocation under subdivision 2-608(1) looks to whether the non-conformity is a substantial impairment of value to the buyer.<sup>293</sup> It

---

296 See U.C.C. § 2-508(1) (1990) (cure only allowed if it can be done before the contractual time for performance has expired).

297 The seller's right to cure should be subject to the buyer's right to demand adequate assurance of performance where applicable. See *infra* text accompanying notes 320-27.

298 An early draft of the comment to what is now § 2-608 explicitly stated that the substantial impairment of value test did not depend on what the seller had reason to know or actually knew. See Comment on Section 98, Revocation of Acceptance in Whole or in Part, 1, in the Llewellyn Papers, file J(IX)(2)(b).

It is the value to the buyer which must be substantially impaired, Subsection 1, preamble. This does not depend . . . on what the seller had reason to know at the time of contracting, as does the recovery of consequential damages . . . . With regard to revocation of acceptance the seller who carries an obligation and whose goods fail to meet that

is possible for the seller to have reasonable grounds to believe that his tender is acceptable, even though that tender substantially impairs the value of the goods to the buyer. Thus, for example, a minor defect within the pattern of acceptance and adjustment, might be a substantial defect to this particular buyer justifying revocation of acceptance.

It is clear that if the seller has notice prior to entering into the contract that strict conformity is required, he has no right to cure under subdivision 2-508(2).<sup>299</sup> If the buyer does not notify the seller and the circumstances of the sale do not otherwise put the seller on notice that strict conformity will be required, the seller should have a right of cure under subdivision 2-508(2) if the non-conformity is within the pattern of acceptance with price adjustment. Subdivision 2-508(2) protects the buyer against serious inconvenience by requiring that the seller cure within a reasonable time.<sup>300</sup>

The most efficient means of clarifying the seller's right to cure when the buyer revokes acceptance is to revise the comments to section 2-508 and/or section 2-608.<sup>301</sup>

*2. Subdivision 2-508(2): Reasonable Grounds to Believe Non-Conforming Tender Would be Acceptable*

Under subdivision 2-508(2), the seller has a right to cure a non-conforming tender even after the time for his performance has expired if the seller had reasonable grounds to believe that its initial tender would be acceptable. The Study Group expresses concern with the imprecision of this "reasonable grounds" test. The imprecision results from the drafters' failure to clearly describe the circumstances that underlie this subdivision. The purpose of the subdivision was to disable a bad faith merchant buyer from avoiding a contract for a minor defect in goods by invoking the literal terms of the contract when the seller had relied on the common mercantile

---

obligation takes his chances, despite absence of advance knowledge, on whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer.

*Id.* (examples omitted).

<sup>299</sup> U.C.C. § 2-508 comment 2 (1990).

<sup>300</sup> U.C.C. § 2-508(2) & comment 3 (1990) ("The words 'a further reasonable time to substitute a conforming tender' are intended as words of limitation to protect the buyer.").

<sup>301</sup> See *supra* text accompanying note 297.

pattern of acceptance of goods with minor defects in return for a price adjustment.<sup>302</sup>

In order to satisfy the "reasonable grounds" test, the seller must prove the pattern of acceptance with adjustment and that the seller was reasonable in believing that this pattern would apply to the rejected tender. Comment 2 to section 2-508 details circumstances in which the seller could not reasonably rely on the pattern.

Two issues that arise under the "reasonable grounds" test remain to be discussed: First, can a seller who is unaware of a non-conformity satisfy the "reasonable grounds" test? Second, is delay in delivery covered by subdivision 2-508(2)?

a. *Can a Seller Who is Unaware of the Non-conformity of its Tender Satisfy the "Reasonable Grounds" Test?*

This issue can arise where the seller obtained the goods from its supplier and did not inspect them before sale to the buyer. It is an issue not addressed in the drafting history. The drafters seem to have assumed that the seller would know of the non-conformity. The resolution of the issue must be accomplished by construing subdivision 2-508(2) in accordance with its underlying purpose.<sup>303</sup> The answer depends on whether the non-conformity is substantial or minor.

(1) *Substantial Defect.* If the non-conformity is a substantial defect and thus not covered by the pattern of acceptance with adjustment, the seller's ignorance of the defect should not give him the right to cure under subdivision 2-508(2). That subdivision protects a seller who relies on the pattern from a buyer who seeks to avoid the contract by invoking the literal terms of the contract and rejecting goods with a minor defect. This risk is substantially different from the risk that the seller's supplier will furnish him with goods that have substantial defects. In the first instance, the seller is unfairly surprised by the buyer's insistence on strict compliance when the buyer has not done so in the past. Consequently, the seller is granted a further reasonable time to comply. In the second instance, it is the supplier who has surprised the seller, and the buyer does nothing wrong when it rejects a defective tender that is outside the pattern of acceptance with adjustment. Here

---

302 See *supra* text accompanying notes 288-89.

303 U.C.C. § 1-102 comment 1.



the supplier, not the buyer, should bear the burden of the costs associated with the defect.

In addition, it is unsound to have the seller's right to cure and, therefore, the buyer's right to rescind, depend on the state of the seller's knowledge. If a substantial defect of which the seller was reasonably unaware could be cured under subdivision 2-508(2), but not a substantial defect of which the seller is aware, then the seller's right to cure would depend on what the seller knows. The less he knows the better. This situation is undesirable.

(2) *Minor Defect.* What about where the seller is ignorant of a minor defect, one that does satisfy the pattern of acceptance with price adjustment? The better answer is to give the seller the right to cure. The reason for this conclusion is that, otherwise, a bad faith buyer, who bases his decision to reject for a minor defect on the condition of the market, will escape sanction. Good faith behavior seems to be the fundamental principle of section 2-508.<sup>304</sup> Furthermore, the seller may have relied on the pattern in non-specific ways. For example, his supplier may have proven to be reliable in the past and furnished conforming goods or goods with only minor defects, so that the seller did not deem it necessary to inspect the goods before tendering them to the buyer. This reliance deserves protection. Finally, it seems unsound as a practical matter to have the buyer's right to rescind the contract turn on the state of the seller's knowledge. The buyer will have to initiate the rescission process by rejecting and stating his reasons. If the seller then offers to cure a minor defect, the buyer cannot know whether or not the seller has that right if the issue turns on whether the seller knew of the defect when it shipped the goods.

In sum, the seller's ignorance of the specific defect should not be relevant in applying the "reasonable grounds" test. If the goods have substantial defects, then the seller should not have the right to cure under subdivision 2-508(2). If the goods have only minor defects, then the seller should have the right to cure.

b. *Is Delay in Tender or Delivery Covered by Subdivision 2-508(2)?*

The Study Group recommends revision of subdivision 2-508(2) so that it covers delay in tender.<sup>305</sup> Although the motive that

---

304 U.C.C. § 1-203 comment (1990).

305 Prelim. Rpt., Part 5, Rec. A 2.5(5)(B), *supra* p. 1137.

prompts the Study Group to recommend this revision is laudable, subdivision 2-508(2) is not the place to deal with rejection for delay in tender.

The basic premise of section 2-508 is that the buyer is ultimately entitled to insist on strict compliance with the terms of the contract.<sup>306</sup> Thus, the text of both subdivisions require the curing seller to make a tender or delivery that is "conforming."<sup>307</sup> It is impossible to cure a delayed tender by substituting a conforming (i.e., timely) tender because *a fortiori* the contractual time for performance has already passed. Accordingly, delayed tenders cannot have been intended to be covered by subdivision 2-508(2).<sup>308</sup>

Nor should subdivision 2-508(2) be revised to include delayed tenders. This change will only muddle the question of what constitutes cure under section 2-508. Now the test is clear: only a tender that conforms to the seller's obligations under the contract is acceptable. If the test is expanded to include delays, which are inherently incurable under section 2-508, the clarity of the original test suffers.

The better approach is to deal with delayed tenders under some other doctrine that sorts out bad faith rejections from good faith rejections. Thus, for example, a court confronted with what it suspects is bad faith rejection for delay might conclude that the delayed tender qualifies under the contract either on the theory that the parties initially understood the delivery term to incorporate any leeway shown by trade usage or course of dealing,<sup>309</sup> or on the theory that the buyer waived past delays and is disabled from

---

306 Comment on Section 5-8 (S77) Cure of Improper Tender or Delivery. Replacement 1 (Mar. 1948) in the Llewellyn Papers, file J(X)(2)(f) (reproduced in App. E); N.C.C.U.S.L., Consideration in Committee of the Whole of the Revised Uniform Sales Act 139 (1943) in the Llewellyn Papers, file J(V)(2)(h); 21 A.L.I., Proceedings at 179 (1944); N.C.C.U.S.L., Report of the Special Committee on the Revised Uniform Sales Act; Appendix (1943), reprinted in N.C.C.U.S.L. Handbook of The N.C.C.U.S.L. and Proceedings of The Fifty-Third Annual Conference at 176 (1943).

307 U.C.C. § 2-106(2) (1990) & comment 2 (indicating that conforming requires "exact performance by the seller of his obligations").

308 Cf. U.C.C. § 2-711 comment 1 (1990) (emphasis added) ("Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, *except for any delay involved.*").

309 U.C.C. § 2-106 comment (1990); General Comment, *supra* note 287, at 1-3.

retracting his waiver as to the tender in question because the seller relied on the waiver and tendered after the time required by the literal terms of the contract.<sup>310</sup> If no trade usage or prior dealings exist that justify delayed delivery, a court could use the general obligation of good faith to frustrate a buyer who rejects in bad faith. The Study Group's recommendation to add an explicit statement to section 2-601 requiring that the buyer reject in good faith will buttress this approach.<sup>311</sup>

### 3. *What Constitutes Cure?*

On this matter the text of each subdivision is quite clear: to cure, the seller must make a "conforming" tender or delivery. This means that the tender or delivery must accord with the seller's obligations under the contract.<sup>312</sup> Two issues arise under this test: can tender of repaired goods or tender of money constitute cure?

#### a. *Can Tender of Repaired Goods Effect A Cure?*

The Study Group takes no position on this issue. It recommends that the Drafting Committee decide when, if ever, repaired goods effect a cure.<sup>313</sup> The original drafters contemplated that, in some instances, tender of repaired goods could effect a cure.<sup>314</sup> Repaired goods should constitute a cure when they satisfy the contract description. This decision is heavily fact dependent. Perhaps the most the Drafting Committee could do would be to include in the comments a statement that repaired goods can effect a cure only when the repaired goods would pass without objection in the trade under the contract description.

#### b. *Can Money Allowance Effect A Cure?*

The Study Group takes no position on this issue, but recommends that it be resolved by the Drafting Committee.<sup>315</sup>

---

310 See sources cited *supra* note 309. See also U.C.C. § 2-209(5) (1990).

311 Prelim. Rpt. Part 6, Rec. A2.6(1)(A), *infra* p. 1158. The Comment to revised § 2-601 should clearly state that where the buyer rejects for a non-conformity which is not the real reason for the buyer's dissatisfaction, the rejection is not in good faith.

312 U.C.C. § 2-106(2) & comment 2 (1990).

313 Prelim. Rpt., Part 5, Rec. A2.5(5)(A), *supra* p. 1136.

314 Cf. U.C.C. § 2-510 comment 2 (repair of goods given as example of cure).

315 *Id.* at Rec. A2.5(5)(B), *supra* p. 1137.

If the contract permits money allowance against the price, section 2-508 does not apply.<sup>316</sup> If not so permitted, a money allowance would not conform to the contract and cannot be a cure under section 2-508. One of the basic premises of that section is that the buyer is entitled to insist upon exact compliance with the terms of the contract.<sup>317</sup> Despite the existence of a pattern of acceptance with price adjustment, if that pattern has not become part of the contract, the buyer can insist on strictly conforming goods. He is not required to take goods with minor defects plus a money allowance.<sup>318</sup>

4. *Suspension of Buyer's Remedies Pending Seller's Cure:  
Relationship of Section 2-508 to Section 2-609*

The Study Group recommends that under both subdivisions of section 2-508, the buyer's remedies for breach be suspended until the seller fails to make a timely or proper cure after properly invoking its right to cure.<sup>319</sup> The Study Group analogizes this result to suspension of the buyer's remedies when the buyer demands adequate assurance of performance under section 2-609. This proposal raises a further issue: what is the relationship of the seller's right to cure and the buyer's right to demand adequate assurance of performance under section 2-609.

a. *Subdivision 2-508(1)*. Suspension of the buyer's affirmative remedies is not necessary under subdivision 2-508(1). That subdivision deals with anticipatory conduct. It clarifies that no anticipatory breach occurs if time remains to retender.<sup>320</sup> Since there is no breach, the buyer has no affirmative remedies to suspend.<sup>321</sup>

As to the relationship of subdivisions 2-508(2) to section 2-609, early drafts of what is now subdivision 2-508(1) gave the seller the right to cure within the contract time only if the buyer

---

316 U.C.C. § 2-508 comment 4 (1990).

317 See *supra* note 306 and accompanying text.

318 The rule is otherwise for installment contracts. See *infra* note 371 and accompanying text (discussing § 2-612). The reference to "money allowance" in U.C.C. § 2-508(2) probably refers to the mercantile pattern of acceptance with price adjustment.

319 Prelim. Rpt., Part 5, Rec. A2.5(5)(C), *supra* p. 1137-38.

320 See *supra* notes 284-85 and accompanying text.

321 The buyer has affirmative remedies only on anticipatory repudiation, U.C.C. § 2-610(b) (1990), or on present breach by the seller, *id.* § 2-711(1).

was given adequate assurance of performance.<sup>322</sup> In response, it was objected that the seller should have the full time specified in the contract to perform without having to put up a bond or make a guaranty for timely performance.<sup>323</sup> Llewellyn, in turn, responded that the buyer should not be left to wonder whether the seller would be able to perform in a timely manner after having initially failed to make a proper tender.<sup>324</sup> The solution was to predicate the right to cure upon the seller's giving notice to the buyer that he would cure within the contract time.<sup>325</sup> In effect, the seller's word that it will cure is treated as adequate assurance for the buyer.<sup>326</sup>

There may, however, be instances in which the buyer should be permitted to utilize the procedures of section 2-609. First, suppose the seller gives notification of his intention to cure, but it reasonably appears to the buyer that the seller may not be able to cure in a timely manner. The buyer should have the right to demand further assurances and to treat the seller as having anticipatorily repudiated if the seller does not comply with that demand. Second, suppose the seller notifies the buyer that it will try, but cannot guarantee, to timely cure. The buyer should not be forced to wait. Perhaps the best solution is to include in the comments a statement that, ordinarily, the seller's promise to cure is sufficient, but that in circumstances similar to those outlined above, the buyer can resort to the procedures of section 2-609.

b. *Subdivision 2-508(2)*. Suspension of the buyer's affirmative remedies is necessary under subdivision 2-508(2). Unlike subdivision 2-508(1), which deals with anticipatory conduct, subdivision (2) deals with present breach, for which the buyer has affirmative remedies under subdivision 2-711(1). Comment 1 to section 2-711 makes the point that a proper cure effectively precludes the buyer's

---

322 Draft for A "Uniform Sales Act, 1940" § 67(4); *reprinted in* 1 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 237 (1984); Revised Uniform Sales Act, Second Draft § 42-A and Comment (1941), *reprinted in* 1. A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 185-86 (1984); Revised Uniform Sales Act: Supplement; Part V, Sections 41-51; Section 42-C(2) (1942) in the Llewellyn Papers, file J(III)(2)(b).

323 N.C.C.U.S.L. Consideration in Committee of the Whole of the Revised Uniform Sales Act 58-60 (1942), *reprinted in* N.C.C.U.S.L., N.C.C.U.S.L. Archives Publications, microfiche 32.0-B(2) (Hein 1983).

324 *Id.*

325 *Id.*

326 *Cf.* U.C.C. § 2-609 comment 4 (1990) (mere promise by seller of good repute suffices as adequate assurance).

remedies. From this statement it might be implied that the buyer's remedies are suspended pending cure, but this point should be expressly stated in either the text or comments to section 2-711.

The drafting history does not contain any discussion of the relationship of the seller's right to cure under subdivision 2-508(2) and the buyer's right to demand adequate assurance of performance under section 2-609. The drafters' silence on this point most likely results from the fact that subdivision 2-508(2) was intended to apply to limited circumstances (seller relying on mercantile pattern of acceptance and adjustment; bad faith buyer invoking literal terms of contract)<sup>327</sup> in which the buyer's expectation of due performance is not materially impaired. On principle, it seems that the seller's offer of cure under subdivision 2-508(2) should be treated the same as an offer of cure under subdivision 2-508(1). Normally, the seller's word that it will cure will suffice. If other circumstances indicate that cure is uncertain or unlikely, however, the buyer should have the right to invoke section 2-609.

[PRELIMINARY REPORT - 2-509]

J. RISK OF LOSS IN THE ABSENCE OF BREACH: §§ 2-509.

1. Introduction.

*Sections 2-509 and 2-510, which deal with risk of loss, are important innovations in Article 2. Section 2-509 rejects title as the test for who has the risk of loss and, instead, puts the risk on the party with control of the goods. This approach assumes that the party in control will be in the best position, cost and other factors considered, to prevent loss or to insure the goods against the loss. Thus, unless reallocated by § 2-510, the "least cost" insurer will bear the risk whether insurance has been obtained or not.<sup>19</sup>*

*There is no evidence that these assumptions about insurance are false or that the clear principles of § 2-509 do not work well in practice.<sup>20</sup>*

---

327 See *supra* notes 287-88 and accompanying text.

19. For example, a seller with the risk who is not insured must bear the economic loss of the goods and may still have obligations to deliver substitutes under the contract. See § 2-613. Similarly, a buyer with the risk of loss who is not insured must bear the economic loss of the goods and may still be liable to the seller for the price. § 2-709(1)(a).

20. See Howard, *Allocation of Risk of Loss Under the UCC: A Transactional Evaluation of §§ 2-509 & 2-510*, 15 U.C.C. L.J. 334 (1983); Comment, *Risk of Loss in Commercial Transactions: Efficiency Thrown Into the Breach*, 65 Va. L. Rev. 557 (1979).

Accordingly, the recommended revisions to § 2-509 will be minor. On the other hand, there is doubt whether § 2-510, a complex provision, serves any useful purpose. More radical surgery on § 2-510, therefore, is required.<sup>21</sup>

A final note. Except for defining insurable interest, § 2-501(2), and invoking the availability of insurance in §§ 2-509 & 2-510, Article 2 has little to say about the law of insurance. Thus, if the parties are in fact insured, non-Code law must be consulted on issues of subrogation, claims against an insured carrier and disputes between insurance companies.<sup>22</sup>

## 2. Revisions in § 2-509.

### *Rec. A2.5 (6).*

Several minor revisions are recommended in the text of § 2-509.

*Interpretation of Shipment Term.* As noted earlier, clarification is required on when "the contract requires or authorizes the seller to ship the goods by carrier," § 2-509(1).

(A) We renew our recommendation that the presumption favoring an "F.O.B. point of shipment" contract, now found in Comment 5 to § 2-503, be elaborated in the text of § 2-319(1) or § 2-503. See *Rec. A2(5)(3)(A)*.

Thus, if the seller is expected to ship the goods by carrier but is not clearly required to deliver them to a particular destination, an F.O.B. point of shipment contract is presumed and the risk of loss passes when they are "duly delivered" to the carrier. § 2-509(1).

*Definition of Carrier.* The word "carrier" in § 2-509(1) is not defined. Suppose the contract requires the seller to ship the goods to the buyer and contains an "F.O.B. the place of shipment" term. Does risk pass to the buyer when the seller loads the goods on a truck or airplane which is owned by the seller or a subsidiary of the seller?

(B) With some dissent, we recommend that the comment be revised to clarify that, unless otherwise agreed, "carrier" does not include a wholly owned subsidiary, operating division or agent of

---

21. The risk of loss provisions in the Convention on Contracts for the International Sale of Goods, §§ 66-70, are difficult to capture in a few sentences. For a good summary, see Roth, *The Passing of Risk*, 27 *Am. J. Comp. L.* 291 (1979). See also, Berman & Ladd, *Risk of Loss or Damage in Documentary Transactions Under the Convention on the International Sale of Goods*, 21 *Cornell Int'l L.J.* 423, 426-31 (1988).

22. See, e.g., R. Keeton & A. Widiss, *Insurance Law* §§ 3.10-3.11 (2d ed. 1988).

the seller.<sup>23</sup> If the vehicle or airplane is not a "carrier," the contract should be interpreted as if the seller was required to deliver the goods to a particular destination. § 2-509(1)(b).

*Bailee Issues.*

(C) We recommend that the phrase "to the buyer" be inserted after the word "bailee" in § 2-509(2)(b). We agree with Judge Posner's analysis and result in the *Jason's Foods* decision.<sup>24</sup> A similar revision was recommended for § 2-503(4)(b).

The word "bailee" in § 2-509(2)(b) is not defined in Article 2. This suggests that it may have a broader or more conventional meaning than that in Article 7.<sup>25</sup> Thus, it is possible for a seller, with the buyer's agreement, to retain possession after tender of delivery and become a bailee of the goods.<sup>26</sup> Can this seller-bailee pass the risk of loss under § 2-509(2)(b) simply by acknowledging the buyer's right to possession even though the risk would not pass under either § 2-509(1) or (3)?

(D) We think that the answer should be no, and recommend that the Drafting Committee consider how better to define who is a bailee for the purpose of the risk of loss policies in § 2-509(2). A possible solution might state that unless the parties have otherwise allocated the risk, § 2-509(4), a seller cannot be a bailee for purposes of § 2-509(2) where the conditions of either § 2-509(1) or 2-509(3) have not been satisfied.

*Risk and the Non-merchant Seller.* In § 2-509(3), a distinction is drawn between a merchant and a non-merchant seller: In the former case, risk of loss passes upon receipt of the goods by the buyer, in the latter case risk passes upon tender of delivery. There is no evidence, however, that the buyer's ability to insure is better when the seller is a non-merchant. We assume that the non-merchant seller in possession will be in a much better position than the buyer to obtain insurance.

---

23. Both CISG §§ 31 & 67(1) and the 1980 INCO Terms support the conclusion that "carrier" does not include transport facilities, such as delivery trucks, operated by the parties. See Honnold at 235-37, 374-76. The converse problem is how far the definition of carrier should be extended. White and Summers suggest that it should include the U.S. Mail. White & Summers at 220.

24. *Jason's Foods Inc. v. Peter Eckrich & Sons, Inc.*, 774 F.2d 214 (7th Cir. 1985).

25. For purposes of Article 7, "bailee" is defined as a "person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them." § 7-102(1)(a). Document of title is defined in § 1-201(15).

26. This should be distinguished from the case where the seller of a horse is requested, after the sale, to stable the horse for a stated period of time until the buyer can take possession. In the latter case, the seller may be a bailee.



*(C) Subject to that assumption, we recommend that the distinction be abolished and a uniform rule that risk passes upon the buyer's "receipt" of the goods be adopted for § 2-509(3).*

[TASK FORCE - 2-509]

#### SECTION 2-509

The Task Force agrees with the Study Group's conclusion that the general policy of this section should not be altered. The section's general policy is that, because it has the best opportunity to and most likely has insured the goods, the party in control of the goods should bear the risk of loss, unless otherwise agreed.<sup>328</sup>

Section 2-509(1) does not define the word "carrier." The question posed is whether, in a shipment contract, the risk passes to the buyer when the seller loads the goods on a truck, airplane or other vehicle owned by the seller. With some dissent, the Report recommends, therefore, that the term "carrier" be defined in the comments to make clear that it does not include a wholly owned subsidiary, operating division, or agent of the seller.

To the degree that this recommendation is consistent with the general assumptions about which party is likely to be insured, it is sound. There is some concern among Task Force members, however, about whether this presumption of insurance is valid based only on the fact that the seller controls the carrier. Further inquiry may be in order.

In section 2-509(3), which governs sales where the goods are neither authorized to be shipped nor held by a bailee, the Code specifies separate rules for merchants and non-merchants.<sup>329</sup> The Report suggests that "[t]here is no evidence, however, that the buyer's ability to insure is better when the seller is a non-merchant. We assume that the non-merchant seller in possession will be more likely to have the buyer obtain insurance."<sup>330</sup>

To the extent that this assumption is correct, the proposal to abolish the distinction between a merchant seller and a non-merchant seller will bring this section in accord with the overarching

---

328 Prelim. Rpt., Part 5, *supra* p. 1149.

329 "In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery." U.C.C. § 2-509(3) (1990).

330 Prelim. Rpt., Part 5, *supra* p. 1151.

policy of section 2-509: to place the risk of loss on the party in the best situation to insure. The remaining issue is whether this assumption is correct. A merchant seller probably will have insured the inventory. The fact patterns of sales by non-merchants, however, do not have enough common factors to clearly justify this assumption. There are simply too many possible variables to make such a broad assumption.

*[PRELIMINARY REPORT - 2-510]*

*K. EFFECT OF BREACH ON RISK OF LOSS: § 2-510.*

*Rec. A2.5 (7).*

*The Study Group recommends that § 2-510 be repealed. Given the tenuous nature of the reallocation policy in § 2-510, the effort required to redraft the statute for clarity in application is not justified. If repeal is rejected, § 2-510 should be revised to insure a link between the breach and casualty to the goods. If the breach is not the substantial cause of the loss, there should be no reallocation of the usual risk of loss outcome.*

*Section 2-510 reallocates the risk of loss in certain cases where one party is in breach. The assumption is that the risk would have passed under § 2-509 but for the breach. But it is not necessary that the breach have caused the loss and there is no obvious connection between the fact of breach and which party is the least cost insurer of the goods. The effect of § 2-510, therefore, is to reallocate the risk from the party in the best position to insure to the contract breacher who, presumably, is not. This result makes little sense in a commercial statute.*

*Even if the reallocation were plausible,<sup>27</sup> § 2-510 is complex, incomplete and difficult to apply. For example:*

*(1) § 2-510(1) applies where a tender of delivery would pass the risk but for the non-conformity. The prototype case is an FOB point of shipment contract where the seller tenders delivery under § 2-504. § 2-509(1)(a). But if the goods were destroyed in the carrier's possession and they were not inspected at the point of shipment, how is it determined whether the buyer had a right of rejection and who has what burden of proof?*

*Perhaps the burden in these cases should be on the seller to prove that the goods conformed to the contract when they were delivered to the carrier.*

---

<sup>27</sup> *There is something appealing about the notion that a contract breacher—the party at fault—cannot pass the risk of loss to the innocent party, particularly where that party is not in fact insured and the buyer could have rejected the goods in any event.*

(2) *Even though the buyer had a rejection right, § 2-510(1) provides that the risk remains on the seller only "until cure or acceptance." Section 2-510(2), however, provides that if the buyer "rightfully revokes acceptance," presumably before the loss,<sup>28</sup> "he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning." What does this mean?*

*Suppose at the time of the loss that the contract price was \$100, the market value of the goods with defects was \$75 and the buyer was insured up to \$50 per unit. What is the deficiency in "effective" coverage, \$25 or \$50? (Probably \$25.) What is the buyer's relief from that deficiency? Since he does not owe the price, § 2-608(3), it is not a price offset. Since the buyer is now just a bailee of the seller's goods, he does not have any ownership interest to insure. § 2-401(4). Does the buyer get to keep the proceeds (a windfall) or must he remit them to the seller? And what about the buyer's insurance company?*

*No answers are provided by the statute or the comments.*

(3) *§ 2-510(3) covers the case where the seller identifies goods to the contract (risk still on seller), buyer breaches (risk still on seller) and then the goods are destroyed. Here, the seller "may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time." Let's suppose that the goods were worth \$100 and the seller was insured up to \$50. Does § 2-510(3) permit the seller to sue the buyer for the deficiency as if it were a suit for the price under § 2-709(1)(a)? This seems plausible, but the answer is not clear.*

#### [TASK FORCE - 2-510]

#### SECTION 2-510

Section 2-510 confuses and complicates questions of risk of loss by mixing them with questions regarding the consequences of breach. Because the general risk of loss rules (section 2-509) operate on presumptions of insurance, which are considerations separate from the risks attendant to breach, there is no clear policy guidance or general principle running throughout section 2-510 to pull the section together and make it coherent. A majority of Task Force members therefore agree with the recommendation to repeal section

---

28. *If the goods were destroyed before the attempt, revocation of acceptance would not be available. § 2-608(2).*

2-510. Those members who do not support repeal agree with the Study Group's alternate recommendation to revise section 2-510 to assure a causal link between the breach and the casualty to the goods.

*[PRELIMINARY REPORT - 2-511]*

**L. TENDER OF PAYMENT BY BUYER; PAYMENT BY CHECK: § 2-511.**

*No revisions are recommended in the text of § 2-511.*

*Assuming that the buyer's duty to tender arises first, § 2-511(1) states, unless otherwise agreed, that "tender of payment is a condition to the seller's duty to tender and complete any delivery." If the seller tenders first, see § 2-507(1), the buyer now has a duty to accept and pay for the goods. Presumably, the buyer must tender payment under § 2-511(1) before the seller is obligated to "complete" the earlier tender of delivery.*

*See Rec. A2.5(4)(A), where the Study Group recommended that unless otherwise agreed the seller should have the obligation to tender first.*

*Rec. A2.5 (8).*

*These clarifications and the proposed revision to § 2-507(1) should be included in a comment to § 2-511.*

*No problems of importance have arisen in determining when a tender of payment is "sufficient," § 2-511(2), and the consequences of dishonor, § 2-511(3).*

**[TASK FORCE - NONE]**

*[PRELIMINARY REPORT - 2-512]*

**M. PAYMENT BY BUYER BEFORE INSPECTION: § 2-512.**

*No revisions are recommended in § 2-512.*

*The buyer normally has a right to inspect the goods "before payment and acceptance." § 2-513(1). The parties, however, may agree otherwise, such as by an agreement for delivery C.O.D. or for payment "against documents of title." § 2-513(3). In these cases, § 2-512(1) states when the buyer must pay even if the goods are non-conforming and § 2-512(2) states that such payment is not an acceptance<sup>29</sup> and does not impair the*

---

<sup>29</sup> Payment coupled with other conduct satisfying § 2-606, however, may constitute an acceptance. *Tonka Tours, Inc. v. Chadima*, 372 N.W.2d 723 (Minn. 1985).

buyer's subsequent right to inspect the goods or "any of his remedies."

*No problems of importance have arisen under § 2-512.<sup>30</sup>*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-513]

**N. BUYER'S RIGHT TO INSPECTION OF GOODS: § 2-513.**

*No revisions are recommended in the text of § 2-513.*

*Unless otherwise agreed, § 2-513(1) provides that the buyer, after the seller's tender or identification of the goods, has a "right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner." In shipment contracts, the time may be "after their arrival."*

*Section 2-513 also allocates the expenses of inspection, § 2-513(2), states when the buyer is not entitled to inspect before payment, § 2-513(2), and covers problems that might arise when the "place or method of inspection" is fixed by the parties. § 2-513(4). These rules are subject to contrary agreement of the parties and are influenced by trade practice and prior course of dealing.<sup>31</sup> There is no litigation of importance under § 2-513 and we are aware of no significant problems in practice.<sup>32</sup>*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-514]

**O. WHEN DOCUMENTS DELIVERABLE ON ACCEPTANCE;  
WHEN ON PAYMENT: § 2-514.**

*No revisions are recommended in the text of § 2-514.*

*This specialized provision should be incorporated into any revision that integrates all sections dealing with documentary transactions.*

---

30. Section 2-512 frequently applies in documentary transactions. § 2-512(1)(a) states that "where the contract requires payment before inspection non-conformity of the goods does not excuse the buyer from so making payment unless (a) the non-conformity appears without inspection. . . ." Clearly, the "unless" clause refers to the "non-conformity" of the goods rather than any non-conformity in the documents. In the latter case, the buyer could reject the tender under § 2-601.

As a practical matter, the "unless" in § 2-512(1)(a) will not arise where the goods are not available for inspection at the time of the demand for payment.

31. See, e.g. *D.C. Leathers, Inc. v. Gelmart Industries, Inc.*, 509 N.Y.2d 161 (App.Div. 1986), where trade usage and past practices between the parties were invoked to support the reasonableness of an inspection.

32. The probabilities are that many buyers discover non-conformities in the goods after acceptance, i.e., where they had a "reasonable opportunity to inspect" the goods and failed to make an effective rejection. § 2-606(1)(b). If so, this suggests that many buyers are not fully utilizing a right that is clearly and reasonably afforded them in § 2-513.

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-515]

**P. PRESERVING EVIDENCE OF GOODS IN DISPUTE:**

§ 2-515.

*No revisions are recommended in § 2-515.*

*Here is another provision of potential importance over which there has been little or no litigation. The inspection right arises after a dispute over quality has arisen. At least one court has held that it must be exercised to further the adjustment of any claim or dispute rather than as a device for discovery after a law suit has been filed.<sup>33</sup> In any event, the right is available without regard to who has what burden to prove either the existence or the breach of a warranty.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-601]

**ARTICLE 2, PART 6:  
BREACH, REPUDIATION AND EXCUSE**

**A. OVERVIEW.**

*Article 2, Part 6 deals with two somewhat distinct sets of problems. The first, covered in §§ 2-601 through 2-612, concerns the power of and procedures necessary for the buyer to reject a tender of delivery, the buyer's duties with regard to rejected goods, acceptance and the consequences of acceptance, revocation of acceptance, adequate assurance of due performance, repudiation and retraction of a repudiation and installment contracts. The second, covered in §§ 2-613 through 2-616, deals with the grounds and procedures for claiming excuse for a failure to perform as agreed and some of the remedial consequences.*

**B. BUYER'S RIGHTS ON IMPROPER DELIVERY: §2-601.**

**Rec. A2.6 (1)**

*A majority of the Study Group recommends minor revisions in § 2-601 and the comments.*

---

<sup>33</sup>. A magistrate's opinion in *Massachusetts*. See 39 U.C.C. Rep. Serv. 1263 (1984).

Because of the potential for abuse by the buyer, the "perfect tender" rule is a matter of some controversy.<sup>1</sup> The image of a buyer rejecting a trivial non-conformity to take advantage of a rapidly falling market price is frequently invoked.<sup>2</sup> Also, the "perfect tender" rule has been rejected for commercial reasons by CISG in international sales.<sup>3</sup> One might expect, therefore, a recommendation to adopt a substantial impairment test in § 2-601.

(A) The Study Group, however, recommends that § 2-601 be maintained as currently drafted, except that the phrase "if acting in good faith" should be inserted after "the buyer" and before "may." Further, the comments and cross-references should be revised to (1) collect in one place all of the limitations upon § 2-601 and (2) clarify the importance of agreement in defining the standards for performance to which the goods or the tender must perfectly conform.

Arguably, the image of buyers engaging in strategic behavior under § 2-601 is illusory. Certainly, that image is not strengthened by the cases, most of which show rejections for reasons consistent with a substantial impairment rather than bad faith.<sup>4</sup> Further, a statutory requirement of substantial impairment emerges indirectly from the limitations imposed upon § 2-601 and the reality that many buyers will accept the goods without discovering the nonconformity and will have to establish "substantial impairment" to revoke acceptance under § 2-608.

Although the current statutory scheme is not very tidy, additional clarity could be achieved by listing in the statutory cross-references all of the limitations on § 2-601 that are not contained in the statute itself, such as §§ 2-508, 2-504, 2-614 and, when an acceptance has occurred, § 2-608.

(B) An alternative proposal, supported by some commentators and some members of the Study Group, requires that § 2-601 be revised to condition rejection upon a nonconformity that "substan-

---

1. For a timeless analysis attacking the rule, see Honnold, *Buyer's Right of Rejection—A Study of the Impact of Codification Upon a Commercial Problem*, 97 U. Pa. L. Rev. 1123 (1949). See also, Lawrence, *The Prematurely Reported Demise of the Perfect Tender Rules*, 35 U. Kan. L. Rev. 557 (1987); Schmitt & Frisch, *The Perfect Tender Rule—An Acceptable Interpretation*, 13 U. Tol. L. Rev. 1375 (1982).

2. Such a rejection may be in bad faith. See *Neumiller Farms, Inc. v. Cornett*, 368 So.2d 272 (Ala. 1979). This problem was explored in an early article, Eno, *Price Movement and Unstated Objections to the Defective Performance of Sales Contracts*, 44 Yale L.J. 782 (1935).

3. Article 46(2).

4. See, e.g., *Carbontex Trading Co. Ltd. v. Phibro Energy, Inc.*, No. 87-1767 (E.D. La., Sept. 12, 1989) (under New York law, facts justifying rejection under § 2-601 also constituted a substantial impairment).

tially impairs the value of the performance to the buyer.”<sup>5</sup> This revision is consistent with the practical effect of current § 2-601, yet, in its “subjective” aspects, provides protection to particular expectations of the buyer. A primary purpose here is to increase the chances that a seller will be able to “cure” before the buyer cancels the contract.<sup>6</sup>

[TASK FORCE - 2-601]

## ARTICLE 2 - PART 6

### SECTION 2-601

The issue of whether to adopt a rule of perfect tender or a rule of substantial performance as a prerequisite to the buyer's right of rejection was debated numerous times over more than a decade during the drafting of Article 2.<sup>331</sup>

The drafters rejected the substantial performance rule for several reasons: “[F]irst, that the buyer should not be required to

5. Karl N. Llewellyn's contention that the right to rejection should be limited to a material breach was supported by the New York Law Revision Commission. See Report of the Law Revision Commission to the Legislature Relating to the Uniform Commercial Code 44 (1956). See also, Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 Harv. L. Rev. 465, 510-21 (1987)(discussing legislative history). Peters agreed. See Roadmap at 215-16.

6. A direct revision might limit rejection to a non-conformity which “substantially impairs the value of the contract to the buyer,” the test now required to revoke acceptance, § 2-608(1). The burden would then be on the parties to contract “into” rather than out of the “perfect tender” rule. If adopted, other sections now limiting § 2-601 should be reviewed for consistency.

Under this revision, a plausible statutory scheme might look like this: (1) The power to reject and the power to revoke acceptance would be the same. Both would be subject to notice conditions, but the revocation power would still have some of the conditions now contained in § 2-608; (2) The seller's power to cure would be broadened in § 2-508 and extended to both rejection and revocation of acceptance; (3) The buyer's power to cancel would be conditioned upon the seller's unwillingness or inability to cure; and (4) Problems associated with the buyer's possession of goods rejected or revoked could be treated in the same sections. For an elaboration, see Seibert, *Rejection, Revocation and Cure Under Article 2 of the UCC: Some Modest Proposals*, 84 Nw. U. L. Rev. #2 (1990)(forthcoming).

331 N.C.C.U.S.L., Consideration in Committee of the Whole of the First Tentative Draft of the Amendments to the Uniform Sales Act 7-17 (1940), reprinted in N.C.C.U.S.L. Archives Publications, microfiche 32.0-A (Hein, 1983); N.C.C.U.S.L., Consideration in Committee of the Whole of the Revised Uniform Sales Act 62-66 (1941) [hereinafter 1941 Annual Conference Transcript], reprinted in N.C.C.U.S.L. Archives Publications, microfiche 32.0-B (Hein, 1983); Malcolm, *Hearing Before Enlarged Editorial Board January 27-29, 1951*, 6 Bus. Law.



guess at his peril whether a breach is material; second, that proof of materiality would sometimes require disclosure of the buyer's private affairs such as secret formulas or processes.''<sup>332</sup> In the earlier debates on substantial performance, fear was expressed that such a rule would result in a flood of litigation due to the uncertainty inherent in such a rule.<sup>333</sup>

In 1956, the Article 2 Subcommittee of the Editorial Board resisted recommendations by the New York Law Revision Commission that the substantial performance rule be adopted. The Subcommittee report to the Law Revision Commission, after reciting the reasons against the rule quoted above, declared, "Individual members of this subcommittee retain their views that the LRC [New York Law Revision Commission] proposal states a better policy than the Code text, but they do not recommend that the matter be reopened now."<sup>334</sup>

The Drafting Committee should reconsider whether to adopt a substantial performance test, as some members of the Study Group recommend.<sup>335</sup> The Drafting Committee should carefully consider the benefits and costs of such a rule. In particular, it should consider whether the adoption of rules permitting a tribunal composed of merchants to decide the substantial performance issue would be a workable solution.<sup>336</sup>

*[PRELIMINARY REPORT - 2-602]*

*C. MANNER AND EFFECT OF RIGHTFUL REJECTION: § 2-602.*

*Rec. A2.6 (2)*

*A major restructuring is recommended for § 2-602. Section 2-602(1) should be combined with § 2-605 to create a new section*

---

164, 194-95 (1951) (editorial board votes to reconcile 2-601 with 2-612); Editorial Board, Uniform Commercial Code, Report No. 5 of the Subcommittee on Art. 2. at 103a (Jan. 18, 1956) in the Braucher Papers, file 26-2 (located in the Harvard Law School Library) [hereinafter Report No. 5 of the Art. 2 Subcommittee].

332 Report No. 5 of the Art. 2 Subcommittee, *supra* note 331.

333 1941 Annual Conference Transcript, *supra* note 331, at 64.

334 Report No. 5 of the Art. 2 Subcommittee, *supra* note 331.

335 Prelim. Rpt., Part 6, Rec. A2.6(1)(B), *supra* p. 1158-59.

336 Revised Uniform Sales Act, Second Draft. Comment on § 11-A, at 101 (Dec. 1941), *reprinted in* 1 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 381 (1983); 1941 Annual Conference Transcript, *supra* note 331.

numbered § 2-602 and entitled "Manner, Effect and Form of Rightful Rejection." Section 2-602(2) should then be combined with § 2-603 to create a new section numbered § 2-603 and entitled "Buyer's Duties as to Rightfully Rejected Goods" and covering the duties of both merchant and non-merchant buyers.

1. *Form, Method and Time of Rejection.*

Assuming that the power to make a rightful rejection exists under § 2-601, § 2-602(1) conditions an "effective" rejection upon action within a reasonable time and upon "seasonable" notice to the seller. The failure to make an "effective" rejection is an acceptance, § 2-606(1)(b), which "precludes rejection of the goods accepted. . . ." § 2-607(2). Is an attempt to reject after acceptance a "wrongful" rejection, and thus a breach by the buyer, see § 2-602(3), or is the buyer simply limited to a possible revocation of acceptance under § 2-608? The latter is apparently correct, see Comment 3 to § 2-602 and the cross-references.

(A) We recommend that the Comments and cross-references be reviewed for clarity, since the interrelationship among these sections is not always apparent.

§ 2-602(1) does not prescribe the form of an effective rejection. Section 2-605, however, deals with the consequences of a failure by the buyer to state a particular defect "in connection with rejection." This section is not cited in either the comments or the cross-references to § 2-602.

(B) We recommend that after a review for clarity, § 2-605 be moved to § 2-602. As revised and integrated, § 2-602 would deal only with the manner, effect and form of a rejection otherwise rightful.

2. *Duties with regard to Rightfully Rejected Goods.*

§ 2-602(2) deals with the some of the buyer's rights and duties with regard to rejected goods. Sections 2-603 and 2-604 provide other duties and rights and § 2-711(3) grants the buyer a security interest in goods in its possession upon "rightful" rejection.

(C) We recommend that § 2-602(2) be combined with § 2-603 to provide in one section all of the buyer's rights and duties with regard to "rightfully" rejected goods. That section (§ 2-603) also would govern the obligations of a buyer who is in possession of goods after a justifiable revocation of acceptance under § 2-608. See § 2-608(3)

In addition, the same rights and duties, to the extent appropriate, should apply where the buyer is in possession after a justifiable revocation of acceptance.

*In this integration, care must be given to achieve consistency in terminology and accurate captions. The following clarifications and questions should be considered.*

*(a) What are the buyer's duties with regard to goods in its possession after a "wrongful" rejection? Section 2-602(3) deals with the seller's remedial rights after a wrongful rejection, but what about the buyer's duties? Are they those of a common bailee or are they governed by § 2-602(2)(b)?*

*(b) It should be clear that "rightful" rejection, as used in §§ 2-602(2), 2-603 and 2-604, means a proper rejection under § 2-601 and an effective rejection under § 2-602(1), and that all rejections governed by those sections are "rightful" rejections. If the rejection is "wrongful," it is a breach of contract. If it is proper under § 2-601 but not effective under § 2-602(1) the buyer has accepted the goods and is subject to § 2-607.*

*(c) New § 2-603 should deal clearly with the effect of an "exercise of ownership" by the buyer over goods in its possession after a rightful rejection or a justifiable revocation of acceptance. Section 2-602(2)(a) makes a pass at this for the former and, presumably, this also covers a revocation. But § 2-602(2)(a) simply states that an exercise of ownership is "wrongful as against the seller" without spelling out the consequences. To further complicate matters, § 2-606(1)(c) states that an act "inconsistent" with the seller's ownership is an acceptance, but if the act is "wrongful" against the seller, the seller must ratify to have an acceptance.*

*An attempt should be made to differentiate three post-rejection or post-revocation "use" situations: (1) Cases where use of the goods imposed a duty to pay for the use but did not impair the validity of the rejection or revocation;<sup>7</sup> (2) Cases where the use either constituted acceptance of the goods or waived the revocation, but was not wrongful against the seller; and (3) Cases where the use or conduct was wrongful, giving the seller a choice between enforcing the contract or bringing an action in tort for conversion.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-603]

#### **D. MERCHANT BUYER'S DUTIES AS TO RIGHTFULLY REJECTED GOODS: § 2-603.**

##### **Rec. A2.6 (3).**

*As discussed under § 2-602, a major restructuring is recommended for § 2-603. Section 2-603 should be expanded to cover the duties of all buyers in possession of rightfully rejected or justifiably*

---

7. See § 2-401(4)(title reverts in seller after an unjustified rejection).

8. A variation of this is where the use neither impaired validity nor imposed a duty to pay.

*revoked goods, with clarifications on the nature and effect of subsequent use and the nature and effect of any post-rejection or post-revocation use.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-604]

**E. BUYER'S OPTIONS AS TO SALVAGE OF RIGHTFULLY REJECTED GOODS: § 2-604.**

*No revisions are recommended in § 2-604.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-605]

**F. WAIVER OF BUYER'S OBJECTIONS BY FAILURE TO PARTICULARIZE: § 2-605.**

*Rec. A2.6 (4).*

*Section 2-605 should be integrated with § 2-602(1) to create a new section, entitled "Manner, Effect and Form of Rightful Rejection."*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-606]

**G. WHAT CONSTITUTES ACCEPTANCE OF GOODS: § 2-606.**

*No revisions are recommended in § 2-606.*

*Section 2-606(1)(c) raises the question discussed under § 2-602: To what extent can a buyer, after rejection or revocation, use the goods without either impairing the remedies in § 2-601 and 2-608 or committing a tort? The need for such use might arise because of delay by the seller in effecting a "cure" or delays in covering. An appropriate answer is that, in these circumstances, the buyer should be able to make use of the goods for a reasonable time upon the payment of reasonable compensation. This limited use should be distinguished from other acts inconsistent with the seller's*

ownership. Again, additional clarity in the lines to be drawn is required.<sup>9</sup>

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-607]

H. EFFECT OF ACCEPTANCE; NOTICE OF BREACH;  
BURDEN OF ESTABLISHING BREACH AFTER  
ACCEPTANCE; NOTICE OF CLAIM OR LITIGATION TO  
PERSON ANSWERABLE OVER: § 2-607.

Rec. A2.6 (5).

Some revisions in the text of § 2-607 are recommended, as noted below.

Section 2-607 collects in one place some important and sometimes controversial consequences of acceptance. In most cases, they place increased burdens on a buyer who has failed, after a reasonable opportunity to inspect, to make an effective rejection. § 2-606(1)(b).

1. Some important burdens of acceptance include: (a) The buyer must pay for the goods at the contract rate. § 2-607(1). This is consistent with § 2-709(1)(a); (b) The buyer cannot reject the goods and, if acceptance was made with knowledge of a non-conformity, it may lose the right to revoke acceptance under § 2-608. § 2-607(2); (c) The burden "to establish any breach with respect to the goods" is placed on the buyer. § 2-607(4).

No revisions are recommended in these subsections.

(2) A controversial burden of acceptance is the notice condition in § 2-607(3)(a).<sup>10</sup> A buyer is "barred from any remedy" if it fails "within a reasonable time after he discovers or should have discovered any breach" to "notify the seller of breach." This subsection operates on the assumption that notice is important to the seller to effect a cure, or to facilitate an effort to negotiate a settlement, or to gather and preserve evidence for possible litigation. All of these are laudable purposes.

One problem is that the buyer is penalized for failing to give notice within a reasonable time after it "should" have discovered the breach. Compare § 2-608(2). Thus, the buyer could lose any remedy even though it had no knowledge of the breach. Compare § 2-725(1). This concern is

---

9. Three other questions to be answered are: (1) Can ordinary use of the goods be distinguished from an "act inconsistent with the seller's ownership," § 2-606(1)(c); (2) Should § 2-606(1)(c) also provide that the buyer must have a "reasonable opportunity to inspect" before the use or act; and (3) Should the buyer be obligated to the seller for any depreciation of the goods during use?

10. See Reitz, *Against Notice: A Proposal to Restrict the Notice of Claims Rule in U.C.C. 2-607(3)(a)*, 73 Cornell L. Rev. 534 (1988).

*softened by the fact that the buyer is given a "reasonable opportunity" to inspect the goods before acceptance and by the importance of prompt and adequate information to efficient dispute resolution.*

*A more important problem is the content of otherwise timely notice. Section 2-607(3)(a) says that the buyer must "notify the seller of breach." Comment 4, however, states, on the one hand, that the "content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched" and, on the other hand, that the "notification which saves the buyer's rights under this Article need only be such as informs the seller that the transaction is claimed to involve a breach. . . ." Some courts, taking a literal approach, have faulted a notice of problems that would arise if a breach occurred and a notice that identified existing problems without claiming a breach.*

*(A) Literal interpretations of the notice requirement should be rejected. Either the text of § 2-607(3)(a) or the comments should be revised to require only that the notice inform the seller that problems have arisen or continue to exist with regard to the accepted goods. Also, the comments should clarify that the buyer has no obligation to notify for breaches of which it has no knowledge.*

*3. The remaining parts of § 2-607 deal with a "vouching in" procedure in breach of warranty claims, § 2-607(5)(a), and special notice and vouching rules where claims of infringement are asserted under § 2-312.*

*(B) The Drafting Committee should consider whether the "vouching" procedure is constitutional and, if so, whether it is needed in light of improvements in third party practice and changes in the scope of the privity defense.*

[TASK FORCE - 2-607]

## SECTION 2-607

The Task Force disagrees with the suggestion that the buyer has no obligation to notify the seller for breaches of which it has no knowledge. Admittedly, there may be cases in which the time for notice begins to run before the buyer learns of the breach, but for several reasons, it is believed that they do not justify a change from the "should have discovered any breach" language of the section. In the first place, the time when the breach should have been discovered is already the benchmark for judging the timeliness

of the buyer's actions under other sections of the Code.<sup>337</sup> It would be anomalous to say that the buyer's right to revoke has expired or that the statute of limitations has run, but that the time for reasonable notice under section 2-607 has not expired.

Second, the Task Force suggests that the penalty provision of section 2-607 be changed from an absolute bar of "any remedy" to a loss of remedy conditioned on the defendant showing that it was in some way prejudiced by reason of the failure to receive timely notice. Such a change would, in many instances, reduce the impact that the existing "discovery" rule would otherwise have on the unknowing buyer.

Finally, the notice requirement as now written reflects the importance of the buyer's right of inspection.<sup>338</sup> The change recommended by the Study Group would weaken the incentive to inspect carefully because the notice requirement is waived for an unknowing buyer.

An issue not dealt with by the Study Group is whether notice must be given when the suit is brought against a remote seller by a buyer claiming third party beneficiary status under U.C.C. section 2-318 or otherwise. It seems that there has been sufficient case law<sup>339</sup> and non-uniform amendments<sup>340</sup> to section 2-607 to justify statutory clarification. The Task Force sees no reason why notice should not be required in all cases, provided that where suit is against a remote seller, the time for giving notice does not begin to run until the seller's identity is or should have been discovered by the buyer.

One final matter considered by the Task Force was the constitutionality of the "vouching" procedure. Based solely on *Asahi Metal Industry Co. v. Superior Court*,<sup>341</sup> the following hypothetical would clearly bring vouching-in into conflict with due process: A

---

337 See, e.g., U.C.C. §§ 2-608(2), 2-725(2) (1990).

338 See U.C.C. § 2-513 (1990) (providing a right to inspect goods).

339 Compare *Simmons v. Clemco Indus.*, 368 So. 2d 509, 513 (Ala. 1979) (claimant who contracted silicosis due to defective sandblasting hoods supplied by employer not required to give notice to manufacturer) with *Parrillo v. Giroux Co.*, 426 A.2d 1313, 1317 (R.I. 1981) (bartender injured by exploding bottle of grenadine was required to give notice to manufacturer within reasonable time).

340 See ME. REV. STAT. ANN. tit. 11, § 2-607 (1966 & Supp. 1990) (notice requirement not applicable to personal injury); S.C. CODE ANN. § 36-2-607(3)(a) (Law. Co-op. 1976) (no notice of personal injury to seller of consumer good is required).

341 480 U.S. 102 (1987).

manufactures tire valves in limited numbers. He sells a few to B, who makes tires and puts the valves in tires. A and B are located in Delaware. A does not know where B sells tires. A does not ask. B sells some of the tires at his branch store in Los Angeles. P buys a tire from B and is injured, allegedly because of a defect in the valve, while riding in California. P sues B, who vouches-in A, in California.

There is an argument, however, that this longstanding procedure<sup>342</sup> might be compared to other so-called "traditional" (non-minimum contacts-based) bases of jurisdiction. For example, the Supreme Court has clearly continued to allow world-wide jurisdiction in true *in rem* cases, as per the discussion in *Shaffer v. Heitner*.<sup>343</sup> Likewise, jurisdiction through service while in the state survives *Shaffer*.<sup>344</sup> A tradition-based argument could be made for vouching-in, although it is probably less established (in a jurisdictional context) than *in rem* proceedings and in-hand service of process.

A stronger argument in favor of the constitutionality of applying the statute in the above mentioned hypothetical, and one which is endorsed by the Task Force, is premised on a contractual waiver of personal jurisdiction rights.<sup>345</sup> If the statute is interpreted as implying the right to vouch-in as one of the terms of the contract, it might constitute an enforceable waiver of the constitutional objection. A re-wording of section 2-607 to make the waiver explicit is suggested.

As an alternative to the above, the Drafting Committee should consider a construction of the statute which limits it to that which is constitutionally permissible. Those who wish to save the existing statute at the expense of giving up the jurisdictional aspect might favor a minor addition ("to the extent permitted by the constitution of this state and of the United States") to clarify the constitutional issue.

---

342 See generally Degnan & Barton, *Vouching to Quality Warranty: Case Law and Commercial Code*, 51 CALIF. L. REV. 471 (1963).

343 433 U.S. 186 (1977).

344 See *Burnham v. Superior Court*, 110 S. Ct. 2105 (1990) (finding that a California court had personal jurisdiction over New Jersey resident who was served with process while temporarily in California for activities unrelated to the lawsuit).

345 Contractual waiver of jurisdiction is well established. See *National Equip. Rental v. Szukhent*, 375 U.S. 311 (1964).



*[PRELIMINARY REPORT - 2-608]**I. REVOCATION OF ACCEPTANCE IN WHOLE OR IN PART: § 2-608.**Rec. A2.6 (6).*

*The following revisions in the text or comments of § 2-608 are recommended.*

*1. Section 2-608 permits a buyer to "revoke" an acceptance under limited circumstances. A proper revocation gives the buyer "the same rights and duties with regard to the goods involved as if he had rejected them." § 2-608(3). Section 2-608, however, does not set forth the effect of a "wrongful," i.e., unjustified, revocation. Clearly, it is a breach of contract, § 2-703, and, presumably, otherwise a nullity.<sup>11</sup>*

*(A) The comments should clarify that unless otherwise agreed, a wrongful rejection is still an acceptance and that the buyer's duties and the seller's remedies are controlled by §§ 2-607 and 2-703.*

*2. There are four types of limitations on revocation of acceptance, all of which must be satisfied under § 2-608: (a) The non-conformity must substantially impair the value to the buyer of a lot or commercial unit (the so-called subjective approach); (b) The failure to act upon or to discover the nonconformity at the time of acceptance must be excusable, see § 2-608(1); (c) Notice of the revocation must be timely; and (d) Revocation must occur before "any substantial change in condition of the goods which is not caused by their own defects." § 2-608(2).*

*No revisions in the four limitations in § 2-608 are recommended. The Comments, however, should elaborate when use of the goods should bar revocation under § 2-608(2).*

*3. Does the seller have the right to "cure" a non-conformity after a rightful revocation of acceptance? The right is not provided in § 2-608, and § 2-508, literally construed, is limited to rejections.*

*(B) The Study Group recommends that §§ 2-608 and 2-508(1) be revised to insure that the seller shall have a right to cure where acceptance is rightfully revoked and the time for performance has not yet expired. The right to cure, however, shall not be available thereafter.*

---

*11. See Roadmap at 240; Comment 5, § 2-709. But see, Wilbur, Wrongful Revocation: An Action For the Price or Damages, 16 W. St. U.L. Rev. 649 (1989).*

4. *To what extent should the buyer be permitted to use goods in its possession after a rightful revocation? This question, which also arises after a rightful rejection, has been litigated with uncertain results.*<sup>12</sup>

*In theory, the buyer is a bailee only and should seek substitute conforming goods through cover. In practice, cover may not be readily available or the seller may delay in making a promised repair or giving appropriate instructions.*

*(C) As previously noted, we recommend that § 2-603 be revised to state clearly in one place the buyer's rights and duties with regard to goods in its possession after either a rightful rejection or revocation of acceptance. In revised § 2-603, the power of the buyer, if any, to use the goods without prejudicing the remedies of rejection and revocation should be stated, along with the compensation that should be paid for use.*

5. *Under § 2-719(1), the parties have power to agree upon a sole and exclusive remedy for breach of contract. This agreement for limited remedies may exclude both rejection and revocation of acceptance. Section 2-719(2), however, provides that where "circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." Assuming such failure of essential purpose and unless otherwise agreed, the remedy of revocation of acceptance should still be available if the conditions of § 2-608 can be satisfied.*

*(D) A Comment clarifying that the remedy of revocation survives the failure of an agreed, limited remedy should be prepared.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-609]

*J. · RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE:  
§ 2-609.*

*No revisions are recommended in the text of § 2-609.*

*The text of § 2-609 consists, mainly, of standards that must be particularized in each case. Certainty and predictability do not reside therein. Nevertheless, the "adequate assurance" process, when invoked, provides important opportunities for communication and clarification between the parties and can facilitate agreed dispute resolution. Despite disagreements*

---

12. See Robertson, *Rights and Obligations of Buyers With Respect to Goods in their Possession After Rightful Rejection or Justifiable Revocation of Acceptance*, 60 Ind. L. J. 663, 679-94 (1985).

*over interpretation, there is no evidence that § 2-609 has failed its intended objectives.*

[TASK FORCE - 2-609]

SECTION 2-609

Contrary to the Study Group's recommendation, the Task Force is of the opinion that there are two areas in which problems might be avoided by certain revisions in the text of section 2-609. First, while the section explicitly requires that the demand for assurances be in writing, some courts have followed the Restatement (Second) of Contracts<sup>346</sup> and have held that no writing is required.<sup>347</sup> For the sake of uniformity, the Task Force favors dropping the writing requirement. Furthermore, to require an insecure party who is satisfied with an oral assurance of performance to make his demand in writing might not always be appropriate. A formal demand for assurance might be viewed as excessive in light of the party's prior relationship, particularly when that relationship has been continuous and friendly.

The second problem area involves excessive demands. Some courts have held that even though there are reasonable grounds for insecurity, an insecure party who makes excessive demands is not entitled to any assurances in return, and may instead find himself in breach for suspending performance while awaiting assurances.<sup>348</sup> This is clearly erroneous. Once the threshold of reasonable grounds for insecurity has been met, the right to demand unconditionally assurances unconditionally accrues to the insecure

---

346 RESTATEMENT (SECOND) OF CONTRACTS § 251 (1979).

347 *See, e.g.,* AMF, Inc. v. McDonald's Corp., 536 F.2d 1167, 1171, 19 U.C.C. Rep. Serv. (Callaghan) 801, 807 (7th Cir. 1976) (plaintiff's "failure to make a written demand was excusable" because the defendant had a "clear understanding" that the plaintiff had "suspended performance until it should receive adequate assurance of due performance"); Kunian v. Development Corp. of Am., 165 Conn. 300, 334 A.2d 427, 12 U.C.C. Rep. Serv. (Callaghan) 1125 (1973) (oral demand for assurances at a meeting between parties was equivalent to a written demand); Toppert v. Bunge Corp., 60 Ill. App. 3d 607, 377 N.E.2d 324 (1978) (oral demand at meeting asking for payment was a demand for adequate assurances under the purposes and policies of the Code).

348 *See, e.g.,* United States v. Great Plains Gasification Assocs., 819 F.2d 831 (8th Cir. 1987); Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572, 18 U.C.C. Rep. Serv. (Callaghan) 931 (7th Cir. 1976).

party. While a party should not have to respond to any unreasonable demands, a party from whom a justified demand is sought must provide "adequate assurances," to the extent they are required under section 2-609.<sup>349</sup> A clarification of this in the text of the section is desirable.

[PRELIMINARY REPORT - 2-610]

K. ANTICIPATORY REPUDIATION: § 2-610.

*Rec. A2.6 (7).*

*The following revisions in the text of or comments to § 2-610 are recommended.*

1. *Except for § 2-609(4), Article 2 does not define when a party "repudiates the contract with respect to a performance not yet due." § 2-610. An attempt at definition is made in the comments, but there are some inconsistencies, especially where conduct is claimed as a repudiation.*

*(A) We recommend that the comments be revised to define repudiation in a style consistent with § 250 of the Restatement, Second. It should be harder rather than easier to establish a repudiation, especially where conduct is involved.<sup>13</sup> A tighter definition encourages the use of § 2-609 and expands the availability of a "safe harbor" against cancellation when there is a good faith dispute over contractual obligations.<sup>14</sup>*

2. *A repudiation of a future performance is not actionable unless the "loss. . . will substantially impair the value of the contract to the other." Under this subjective test, if the contract is 90% performed or only the next installment is repudiated, see § 2-612, the uncertainty over whether a*

---

349 Cf. *In re Luce Indus., Inc.*, 8 Bankr. 100, 108 (Bankr. S.D.N.Y. 1980) (the assurance provided does not have to be that which is requested; "[s]o long as the assurance is adequate, it will satisfy [11 U.S.C. § 356]").

13. Under § 250, a "repudiation is (a) a statement by the obligor to the obligee indicating that the obligor will commit a . . . total breach. . . , or (b) a voluntary affirmative act which renders the obligor unable or apparently unable to perform without such a breach."

14. The courts and commentators agree that the test for repudiation is objective and that one form of repudiation occurs when a party, without justification, states that he will not perform a material part of the future performance unless the other party agrees to a modification of the contract. See E. A. Farnsworth, *Contracts* §§ 8.20 & 8.21 (1982). There is less agreement whether withholding future performance until resolution of a good faith dispute arising under the contract is a repudiation. Given the importance of agreed dispute resolution and preserving the contract, there should be some room for a "safe harbor" in this setting and the boundary should be made clearer. For a suggestive analysis, see Rosett, *Partial, Qualified, and Equivocal Repudiation of Contract*, 81 Colum. L. Rev. 93 (1981).

cancellation is justified may induce the aggrieved party to invoke the "adequate assurance" mechanism in § 2-609.

**(B)** We support the subjective test and recommend that it be used in other sections, e.g., §§ 2-608(1) and 2-612, where the substantial impairment requirement is contained.

3. If the elements of repudiation and "substantial impairment" are satisfied, § 2-610 gives the aggrieved party several remedial options.

First, it may await performance by the repudiating party "for a commercially reasonable time. . . .," § 2-610(a), and "suspend his own performance." § 2-610(c).<sup>15</sup> A buyer who follows this course of action takes the risk that the repudiator may retract the repudiation. § 2-611.<sup>16</sup> What is the effect, however, of waiting for more than a commercially reasonable time? Does the aggrieved party waive the power to cancel the contract or lose the implied right to perform under the contract and seek damages? Or, does the suspended duty to perform now become a breach? Or, may the aggrieved party still "resort to any remedy for breach?" § 2-610(b). The latter solution appears to be sound, although the text is not clear.<sup>17</sup>

**(C)** We recommend revisions in the comments to clarify these relationships.

Second, unlike § 2-612(3), § 2-610(b) appears to give a party aggrieved by a repudiation more latitude to urge action inconsistent with cancellation without losing the power to cancel. Section 2-610(b), for example, states that the aggrieved party may resort to any remedy "even though he has notified the repudiating party that he would await the latter's performance and has urged retraction." Presumably, if the aggrieved party continued to perform the repudiated contract or sued for specific performance, the power to cancel would be waived. Conversely, if the aggrieved party canceled the contract for breach, the power subsequently to treat the contract as in force would be terminated.<sup>18</sup>

**(D)** Again, the comments should be revised to clarify what conduct is sufficiently inconsistent with a repudiation that the power to cancel is waived.

---

15. The aggrieved party's discretion to wait a "commercially reasonable time" preserves remedial options but does not provide a measure of damages. See §§ 2-708(1) & 2-713 and the recommended revisions at Rec. A2(7)(11)(A). *infra*.

16. Leary and Frisch argue that the power of the repudiator under § 2-611 to unilaterally reinstate the contract is unsound and should be reexamined. Revision at 463-65.

17. See Rec. A27(11)(A), *infra*, for discussion of the relationship between § 2-610(a) and the damage formula in §§ 2-708(1) and 2-713.

18. See Peters, Roadmap at 263-67, who worries through some of these problems.

*Third, the relationship between the remedial options provided in § 2-610 and the power to cancel the contract given in § 2-703 and § 2-711(1) is not always clear. "Cancellation" is defined in § 2-106(4), but Article 2 does not state what action constitutes cancellation or what procedures or notice should be invoked to effect it.*

*(E) Assuming that an aggrieved party has power to cancel all or part of the remaining contract under § 2-610 and either § 2-703 or § 2-711(1), we recommend that the Drafting Committee consider whether the content of and procedures for cancellation should be more fully elaborated.*

[TASK FORCE - NONE]<sup>350</sup>

[PRELIMINARY REPORT - 2-611]

**L. RETRACTION OF ANTICIPATORY REPUDIATION: § 2-611.**

*No revisions are recommended in the text of § 2-611.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT- 2-612]

**M. "INSTALLMENT CONTRACT": BREACH: § 2-612.**

*Rec. A2.6 (8).*

*We recommend several revisions in the text of and the comments to § 2-612.*

*1. No major problems exist in the definition of an installment contract. Transactions such as "take or pay" contracts are installment contracts under § 2-612(1) because the bargain "authorizes" delivery of goods in separate lots even though the buyer may decide always to pay and never to take.<sup>19</sup>*

*2. Section 2-612(2) deals with the buyer's power to reject a non-conforming installment. A non-conformity in goods must "substantially impair the value of that installment and cannot be cured." There is no persuasive reason why a substantial impairment test should be invoked for*

---

<sup>350</sup> But see *infra* text accompanying notes 389-93 (discussing problems with purely subjective test for total breach).

<sup>19</sup> But see Roadmap at 223-24, where Peters suggests that the result is not so clear.

rejection of a single installment, although there is a stronger justification for a broader power by the seller to cure in an installment contract.

(A) A majority of the Study Group<sup>20</sup> recommends the following revisions in § 2-612(2) or the comments: (a) The "perfect tender" rule should be available to the buyer or seller when an installment fails to conform "in any respect to the contract"; (b) In a continuing relationship, the seller should have power to "cure" the nonconformity which is as broad as that granted in § 2-508(1), even though the time for performance of that installment has passed; and (c) The comments should clarify when the failure to the seller to cure the non-conformity justifies cancellation of the entire contract.<sup>21</sup>

3. § 2-612(3) states when a breach with regard to one or more installments "is a breach of the whole" and, assuming that such a breach has occurred, when certain inconsistent conduct by the aggrieved party "reinstates the contract."

(a) Since a "breach of the whole" gives the aggrieved party power to cancel the contract, one question involves the test for substantial impairment. Unlike § 2-610 and § 2-608(1), § 2-612(3) appears to exact an objective test: The non-conformity must "substantially impair the value of the whole contract" to a reasonable person, not simply impair the value of the whole contract "to him." Thus, it is harder to cancel an installment contract (presumably there is a policy to preserve these contracts) and more incentive to use the adequate assurance mechanism in § 2-609.

(B) The Study Group, with one dissent, recommends that the "subjective" test of substantial impairment be adopted for § 2-612(3). This achieves consistency in the statement of that test without undue risk to the security of installment contracts and without undercutting the utility of § 2-609.

(b) The second sentence of § 2-612(3) provides that an aggrieved party "reinstates the contract" if, after a breach of the whole, it engages in inconsistent conduct, such as demanding "performance as to future installments." A more accurate statement is that the aggrieved party "waives the power to cancel" by such conduct, not "reinstates" a contract that has not yet been canceled.

---

20. This recommendation assumes that the "perfect tender" rule is preserved in § 2-601.

21. Section 2-612(2) now provides, in essence, that if the default in one installment is insufficient to justify cancellation of the entire contract, § 2-612(3), and the seller gives "adequate assurance of its cure," the buyer "must accept that installment." The text, however, does not say what happens if the seller fails to cure or to give "adequate assurance" of cure. A preferred answer is that, after the seller's failure, the buyer should invoke § 2-609 and demand adequate assurance with regard to the entire contract.

rejection of a single installment, although there is a stronger justification for a broader power by the seller to cure in an installment contract.

(A) A majority of the Study Group<sup>20</sup> recommends the following revisions in § 2-612(2) or the comments: (a) The "perfect tender" rule should be available to the buyer or seller when an installment fails to conform "in any respect to the contract"; (b) In a continuing relationship, the seller should have power to "cure" the nonconformity which is as broad as that granted in § 2-508(1), even though the time for performance of that installment has passed; and (c) The comments should clarify when the failure to the seller to cure the non-conformity justifies cancellation of the entire contract.<sup>21</sup>

3. § 2-612(3) states when a breach with regard to one or more installments "is a breach of the whole" and, assuming that such a breach has occurred, when certain inconsistent conduct by the aggrieved party "reinstates the contract."

(a) Since a "breach of the whole" gives the aggrieved party power to cancel the contract, one question involves the test for substantial impairment. Unlike § 2-610 and § 2-608(1), § 2-612(3) appears to exact an objective test: The non-conformity must "substantially impair the value of the whole contract" to a reasonable person, not simply impair the value of the whole contract "to him." Thus, it is harder to cancel an installment contract (presumably there is a policy to preserve these contracts) and more incentive to use the adequate assurance mechanism in § 2-609.

(B) The Study Group, with one dissent, recommends that the "subjective" test of substantial impairment be adopted for § 2-612(3). This achieves consistency in the statement of that test without undue risk to the security of installment contracts and without undercutting the utility of § 2-609.

(b) The second sentence of § 2-612(3) provides that an aggrieved party "reinstates the contract" if, after a breach of the whole, it engages in inconsistent conduct, such as demanding "performance as to future installments." A more accurate statement is that the aggrieved party "waives the power to cancel" by such conduct, not "reinstates" a contract that has not yet been canceled.

---

20. This recommendation assumes that the "perfect tender" rule is preserved in § 2-601.

21. Section 2-612(2) now provides, in essence, that if the default in one installment is insufficient to justify cancellation of the entire contract, § 2-612(3), and the seller gives "adequate assurance of its cure," the buyer "must accept that installment." The text, however, does not say what happens if the seller fails to cure or to give "adequate assurance" of cure. A preferred answer is that, after the seller's failure, the buyer should invoke § 2-609 and demand adequate assurance with regard to the entire contract.



(C) *We recommend that § 2-612(3) be revised to this effect. Also, we recommend that the Drafting Committee consider whether an indication in the text of what conduct under § 2-610 “waives” the power to cancel is necessary. Ideally, a single subsection dealing with the “waiver” issue for all breaches of the whole makes sense.*

(D) *The comments should be revised to clarify that the remedy of revocation of acceptance should be available under § 2-612, subject to the seller’s right to cure under § 2-508(1).<sup>22</sup>*

*In 1963, Professor Peters, after suggesting that § 2-612 was a “law professor’s delight,” recommended revisions that would “apply evenhandedly to both buyers and sellers.”<sup>23</sup> Her analysis should be carefully considered by the Drafting Committee. In addition, the concept of “material” breach expressed in §§ 2-608, 2-610 and 2-612 should be carefully reviewed.<sup>24</sup>*

#### [TASK FORCE - 2-612]

#### SECTION 2-612

This section contains special rules applicable to “installment contracts,” as that term is defined in subdivision 2-612(1).

##### 1. *Subdivision 2-612(1): Definition of “Installment Contract”*

The Study Group finds that no major problems exist with the definition of “installment contract.” Consequently, the Study Group does not recommend any changes. The Preliminary Report does, however, note that Justice (then Professor) Peters did raise a problem with the definition.<sup>351</sup>

Peters’ concern was that the definition is ambiguous when applied to a contract permitting deliveries, but not payments, to be made in installments, if it is not feasible to apportion the price for each installment. Peters concluded that such a contract would be within the subdivision 2-612(1) definition.<sup>352</sup>

---

22. For an excellent analysis, see Patterson, *UCC Section 2-612(3): Breach of an Installment Contract and a Hobson’s Choice for the Aggrieved Party*, 48 *Ohio St. L.J.* 177 (1987).

23. Roadmap at 223-27.

24. See Andersen, *A New Look at Material Breach in the Law of Contracts*, 21 *U.C.D. L. Rev.* 1073 (1988).

351 Prelim. Rpt., Part 6 n.19, *supra* p. 1173.

352 Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two*, 73 *YALE L.J.* 199, 223-24 (1963).

The drafting history of section 2-612 demonstrates that Peters' conclusion is correct. In 1954, the relevant portion of subdivision 2-612(1) read, "An 'installment contract' is one which requires or authorizes the delivery of goods in separate lots to be separately accepted and paid for . . . ."<sup>353</sup> The New York Law Revision Commission recommended that the words "and paid for" be deleted.<sup>354</sup> The Editorial Board's Article 2 Subcommittee initially resisted the change on the grounds that the text "follows Uniform Sales Act Section 45(2) and seems not to have caused difficulty."<sup>355</sup>

In response to the Subcommittee report, Professor John Honnold, writing in his personal capacity, implored the Subcommittee to give further consideration to a number of sections, including subdivision 2-612(1).<sup>356</sup> He reasoned that, under the existing definition, a contract calling for separate deliveries but one payment would be excluded from section 2-612. Honnold asserted that such contracts are even more a unit and are more appropriate for coverage by section 2-612 than contracts that call for separate shipment and separate payment.<sup>357</sup> The Editorial Board subsequently adopted this recommendation and deleted the words.<sup>358</sup>

---

353 U.C.C., Official Draft, Text and Comments Ed., 1952, With Changes and Modifications Approved by the Enlarged Editorial Board at Meetings Held on December 29, 1952, February 16, 1953, May 21, 1953, and December 11, 1953, at 211, *reprinted in* 16 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 243 (1983).

354 1956 N.Y. State Law Revision Comm'n Report 393 (No. 65). The reason for recommending the deletion presumably was the one advanced by Professor John Honnold, then a Research Consultant to the Law Revision Commission: "[T]he right to demand payment separately for each lot relates to the remedy and is not properly a part of the definition of an installment contract." See 1-1955 N.Y. State Law Revision Comm'n Report 543 ("There seems to be no apparent reason why rights to cancel, or obligation to accept defective installment, should turn on whether installments are to be separately . . . paid for.").

355 Uniform Commercial Code, Report to the Editorial Board of the Subcommittee on Article 2, Status of Sections and Answers to Unaccepted Recommendations 11 (Sept. 4, 1956) in the A.L.I. Archives, Drawer 198 [hereinafter Sept. 4, 1956, Article 2 Subcommittee Report].

356 J. Honnold, Comments on the September 4, 1956, Report of the ALI Subcommittee on Article 2 of the Uniform Commercial Code at 7 (Oct. 3, 1956) (available in the A.L.I. Archives, Box 697).

357 *Id.* See also Honnold, *Buyer's Right of Rejection, A Study in the Impact of Codification Upon a Commercial Problem*, 97 U. PA. L. REV. 457, 477 (1949) (stating that "[i]t would be startling to conclude that the special rules which apply because separate deliveries are embraced by a single contract may not also apply when the deliveries are even more closely linked by common payment").

358 1956 Recommendations of the Editorial Board for the U.C.C. 69 (1957), *reprinted in* 18 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 93 (1983).

Thus, it is clear that a contract permitting separate deliveries but not separate payments is an installment contract under subdivision 2-612(1).

2. *Subdivision 2-612(2): When a Non-Conforming Installment Can Be Rejected*

a. *Standard for Rejection of Single Installment*

Subdivision 2-612(2) permits a buyer to reject a non-conforming installment only if the non-conformity substantially impairs the value of the installment and cannot be cured, or if the non-conformity is a defect in the required documents. Contrary to present subdivision 2-612(2), a majority of the Subcommittee recommends (assuming that the perfect tender rule is retained for rejection under subdivision 2-601) that the perfect tender rule be available to the buyer or seller when an installment fails to conform to the contract in any respect.<sup>359</sup> Presumably, this means that the buyer or seller should have the right to reject an installment for any non-conformity, even one that is immaterial. The reason given for this recommendation is that "[t]here is no persuasive reason why a substantial impairment test should be invoked for rejection of a single installment, although there is a stronger justification for a broader power by the seller to cure in an installment contract."<sup>360</sup>

The proposal to provide a perfect tender rule for rejection of installments was made several times during the drafting history of Article 2.<sup>361</sup> It was rejected each time by the drafters in favor of the rule now contained in section 2-612(2). The drafters gave the following reason for limiting the buyer's right to reject an installment: "The fact of a continuing relationship normally justifies a less rigid standard for installment contracts than for contracts for

---

359 Prelim. Rpt., Part 6, Rec. A2.6(8)(A), *supra* p. 1174.

360 Prelim. Rpt., Part 6, *supra* p. 1173-74.

361 See, e.g., Memorandum of Task Group of the Special Committee of the Commerce and Industry Association of New York, Inc. on the U.C.C. on Article 2, Sales and Article 6, Bulk Transfers, *reprinted in* 1-1954 N.Y. Law Revision Comm'n Report (No. 65) at 104. See also 1-1954 N.Y. Law Revision Comm'n Report at 635.

a single delivery, covered by section 2-601.<sup>362</sup> In addition, Llewellyn asserted several times that the limitations on the buyer's right to reject an installment were reflected in case law and mercantile practice.<sup>363</sup> Yet, Peters asserts that pre-Code law permitted the buyer to reject an installment for minor defaults.<sup>364</sup> At the very least, before any changes are made, this apparent conflict ought to be resolved.<sup>365</sup>

---

362 Supplement No. 1 to the 1952 Official Draft of Text and Comments of the U.C.C. 106 (Jan. 1955), *reprinted in* 17 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 424 (1983).

Grant Gilmore described the drafting history in typically colorful fashion:

There was a considerable controversy in the early days of the Code as to why the Code had, apparently, although stating the strong substantial performance rule in § 2-612 with respect to installment contracts, restated what many people considered this exploded theory of perfect tender in § 2-601. I think at that point few people realized how much substantial performance there was buried in other, apparently unrelated, sections of the Code to cut back § 2-601. There was considerable tendency in the academic discussions of the problem in law review articles to say that § 2-601 was all wrong and what the draftsman ought to have done was to have adopted a straight substantial performance rule all the way through.

I remember hearing Professor Llewellyn discuss this problem once. He put it this way: He said that one of his advisers in the early years of drafting the sales article had been a Mr. Hiram Thomas of Boston, a Boston lawyer, for whom Llewellyn had great admiration, indeed reverence. Llewellyn said there was one meeting at which Hiram Thomas explained why it was that the perfect tender rule of § 2-601 was right with respect to ordinary contracts and the substantial performance rule of § 2-612 was right with respect to installment contracts. Anyone who heard Mr. Thomas that day, said Llewellyn, would be in no doubt that both sections were right. Unfortunately, said Llewellyn, he had since forgotten exactly what it was that Mr. Thomas said, and Mr. Thomas had since died, so that there was no way of reconstructing just why it was that § 2-601 was a good section of its type and § 2-612 was a good section its type. But Professor Llewellyn was adamant that they were both right and that Mr. Thomas had once known the reason. (Laughter)

A.L.I. and A.B.A., Advanced ALI-ABA Course of Study on Banking and Secured Transactions Under the Uniform Commercial Code 145 (1968). *See also* Honnold, *supra* note 357, at 477-88.

363 Informal Appendix to Revised Uniform Sales Act, Third Draft, 1943, Tentative Sketch of Material for Comments 45-46 (1943) (available in the A.L.I. Archives, Drawer 202). *See also* 21 A.L.I., *Proceedings* 191, 197 (1944).

364 Peters, *supra* note 352, at 224-25.

365 Preliminary research favors Llewellyn's view. *See* 1 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT 578 (rev. ed. 1948); 2 *id.* 701 at n.19, 729 at n.8, 730 at n.15, 776 at n.2 & 780.

In any event, in an installment contract, the buyer should be required to accept non-conforming installments if the seller gives adequate assurance of cure.<sup>366</sup> This result will maximize the opportunities for the deal to continue and for each side to get that for which they bargained. In effect, this rule requires the buyer and seller to cooperate to resolve non-conformities.<sup>367</sup> If the non-conformity is insubstantial, Llewellyn believed that money allowance would always suffice.<sup>368</sup> If the non-conformity is substantial, it should be cured. But the concept of cure in this section should be and is more flexible than under section 2-508. Under section 2-508, the cure must conform to the contract; that is, the buyer may insist on exact compliance with the literal terms of the contract<sup>369</sup> and he need not accept the goods until they conform. Under subdivision 2-612(2), however, the seller is not held to exact compliance with the literal terms.<sup>370</sup> Deficiencies in quantity or quality commonly are made up in later installments. Money allowance is permissible here,<sup>371</sup> but not under 2-508.<sup>372</sup> Additionally, under subdivision 2-612(2), the buyer is required to accept the installment if the seller gives assurance of cure.

The rule, supported by a majority of the Study Group, which would permit the buyer to reject for any defect and require a precisely conforming retender by the seller, increases the likelihood that the deal will break down. It is a rule that will tend to "snow-ball" partial breaches into total breaches. This result can only

---

366 This discussion assumes that the non-conformity does not substantially impair the value of the whole contract under U.C.C. § 2-612(3) (1990).

367 Cf. Selected Comments to Uniform Revised Sales Act, General Comment on Parts II and IV. Formation and Construction 15 (1948) in the Llewellyn Papers, file J(IX)(2)(a) [hereafter General Comment] (reproduced in App. A); U.C.C. § 2-612 comment 5 (1990) (requiring reasonable action by buyer to facilitate cure by seller); Comment on Section 7-9 (S 101) Breach in Installment Contracts 10-11 (1948) in the Llewellyn Papers, file J(IX)(2)(b) [hereinafter Comment on Section 7-9] (reproduced in App. F).

368 21 A.L.I., *Proceedings* 197 (1944). Cf. U.C.C. § 2-612 comment 5 (1990) ("Cure of non-conformity of an installment in the first instance can usually be afforded by an allowance against the price . . .").

369 See *supra* notes 306-07 and accompanying text (discussing § 2-508).

370 Compare the treatment of defects in required documents where the perfect tender rule for rejection does apply, but the seller has the right to make a timely conforming retender of documents. See *infra* notes 373-75 and accompanying text.

371 U.C.C. § 2-612 comment 5 (1990).

372 See *supra* notes 317-18 and accompanying text (discussing § 2-508).

serve to aid the party who wants to cancel for reasons having nothing to do with the asserted non-conformity.

The Study Group's recommendation of a perfect tender rule for rejection of an installment is coupled with the recommendation that the seller have a right to cure "as broad as that granted in section 2-508(1) even though the time for performance of that installment has passed."<sup>373</sup> This statement indicates that the Study Group may not have properly understood the scope of the seller's respective rights to cure under sections 2-508 and 2-612.

The seller's right to cure a defect in an installment under subdivision 2-612(2) is broader than the seller's right to cure under subdivision 2-508(1).<sup>374</sup> The differences between these subsections is illustrated by the disparate treatment in subdivision 2-612(2) of defects in goods compared with defects in documents. Defects in goods are governed by the installment contract rules of subdivision 2-612(2). Defects in documents are expressly excluded from the coverage of that subdivision because, in documentary sales, the rule is that the documents must strictly comply with the contract.<sup>375</sup> Nevertheless, cure of defective documents can be accomplished under section 2-508 if appropriate documents are readily available.<sup>376</sup>

b. *Effect of Seller's Failure to Cure or to Give Assurance of Cure*

The Study Group recommends that the comments to section 2-612 be revised to clarify when the failure to cure a non-conformity justifies cancellation of the entire contract.<sup>377</sup> The Preliminary Report suggests in a footnote that if the seller fails to cure or to give adequate assurance of cure, the buyer should be able to invoke section 2-609 and demand adequate assurance as to the entire contract.<sup>378</sup>

This suggestion is a proper solution only if the failure to cure or to give assurance of cure impairs the buyer's expectation of receiving due performance of future installments. Thus, if the seller

---

373 Prelim. Rpt., Part 6, Rec. 2.6(8)(A), *supra* p. 1174.

374 See *supra* notes 368-72 and accompanying text.

375 General Comment, *supra* note 367, at 4-5; U.C.C. § 2-508 comment 2 (1990).

376 U.C.C. § 2-612 comment 5 (1990).

377 Prelim. Rpt., Part 6, Rec. A2.6(8)(A), *supra* p. 1174.

378 Prelim. Rpt., Part 6 n.21, *supra* p. 1174.

were to insist that the installment in question was not defective and that he would continue to deliver in like fashion, the buyer's expectation of proper future performance would be impaired. In this case, resort to section 2-609 is proper.

In some instances, however, the seller's inability does not impair the buyer's expectation of future performance. Suppose, for example, that part of the installment had been damaged enroute to the buyer, and that replacement goods were not readily available. If the seller had sufficient undamaged goods on hand to fulfill future installments, the buyer's expectation of future performance would not be impaired. In these circumstances, the buyer's right to cancel would depend on whether the present breach, the damage to the delivered installment, was so great as to substantially impair the value of the whole contract. This question does not involve section 2-609. Therefore, the Subcommittee's suggestion that the buyer can invoke section 2-609 if the seller fails to cure is not entirely correct.

The matter seems to be sufficiently covered in comment 6 to section 2-612. Therefore, unless the case law demonstrates a problem, there is no need to revise the comments in the fashion suggested.

### 3. *Subdivision 2-612(3): Substantial Impairment of the Whole Contract*

The drafters intended to carry forward the policy of the Uniform Sales Act (U.S.A.) section 45(2) in regard to breaches of the whole contract.<sup>379</sup> That policy essentially weighed the interest of the aggrieved party against the interest of the breaching party.<sup>380</sup>

---

379 Compare Comment on Section 7-9, *supra* note 367, at 6 (section follows test of *Helgar Corp. v. Warner's Features Inc.*, 222 N.Y. 449, 119 N.E. 113 (1918)) with 2 WILLISTON, *supra* note 365, at 752-53 (endorsing *Helgar* analysis as consistent with U.S.A. § 45(2) (1950)).

380 U.S.A. § 45(2) (1950) provided, in pertinent part:

[I]t depends in each case on the terms of the contract and the circumstances of the case, whether the breach of contract is so material as to justify the injured party in refusing to proceed further and suing for damages for breach of the entire contract, or whether the breach is severable, giving rise to a claim for compensation but not to a right to treat the whole contract as broken.

Williston, the drafter of the U.S.A. and the Restatement of Contracts, saw this test as requiring a weighing of interests. See 2 WILLISTON, *supra* note 365, at 752-53 (endorsing the *Helgar* analysis). See also RESTATEMENT OF CONTRACTS § 275 (1932).

Judge Cardozo authored the most popular statement of this test. Speaking of when failure to pay for an installment constituted a material breach under U.S.A. section 45(2), he wrote:

We must know the cause of the default, the length of the delay, the needs of the vendor, and the expectations of the vendee. If the default is the result of accident or misfortune, if there is a reasonable assurance that it will be promptly repaired, and if immediate payment is not necessary to enable the vendor to proceed with performance, there may be one conclusion. If the breach is willful, if there is no just ground to look for prompt reparation, if the delay has been substantial, or if the needs of the vendor are urgent so that continued performance is imperiled, in these, and in other circumstances, there may be another conclusion.<sup>381</sup>

This analysis was endorsed by Williston, the Code drafters, and practically every other commentator who discussed breaches of the whole.<sup>382</sup> The Code drafters adopted it for subdivision 2-612(3).<sup>383</sup>

The reason for using terminology different from the U.S.A. in subdivision 2-612(3) results from the drafting decision to cover only present breaches of the whole in subdivision 2-612(3).<sup>384</sup> Future breaches of the whole, that is, anticipatory total breaches (repudiation), are governed by section 2-610.

a. *Subdivision 2-612(3) Covers only Present Breaches of the Whole*

Breaches of the whole are of two types: (1) present total breaches, and (2) anticipatory total breaches or repudiation. Subdivision 2-612(3) deals with present total breaches. These are situations in which the default in the installment(s) then due is so great as to justify immediate cancellation of the whole contract on the basis of the present default alone.<sup>385</sup> Thus, for example, suppose a seller failed to deliver the second of four equal installments

---

381 Helgar Corp., 222 N.Y. at 454, 119 N.E. at 114.

382 See *supra* note 380 (discussing relevant authority).

383 Comment on Section 7-9, *supra* note 367, at 6.

384 *Id.* at 5-6, 6-7.

385 Cf. 2 WILLISTON, *supra* note 365, at 776-77.



because the goods had been destroyed under circumstances in which the seller is not excused and where the seller is unable to procure substitute goods. Here, the buyer likely would be permitted to cancel the entire contract under subdivision 2-612(3), even though the seller was willing and able to deliver the remaining installments.

Anticipatory total breaches are covered by section 2-610 and section 2-609. Thus, if a seller were to repudiate its obligation to deliver the second installment before delivery became due, the buyer could cancel the rest of the contract. This right to cancel, however, arises under section 2-610, not subdivision 2-612(3).<sup>386</sup>

Particularly troublesome under pre-Code law was the situation where present conduct or breach indicated possible breach of future installment obligations, but was equivocal and, thus, not a repudiation. The solution under section 2-609 is to permit a party whose expectation of future performance has been impaired to force a clarification of the matter. Thus, if the buyer has legitimate doubts about the seller's ability to deliver future installments, his remedy is to proceed under section 2-609.<sup>387</sup> It is even possible that a present breach that does not substantially impair the value of the whole contract might impair the buyer's expectation of future performance, thereby justifying resort to section 2-609.<sup>388</sup>

In sum, subdivision 2-612(3) applies to present breaches, not anticipatory breaches.

b. *"Subjective" versus "Objective" Substantial Impairment*

The Study Group recommends that a "subjective" test of substantial impairment be adopted for subdivision 2-612(3).<sup>389</sup> Presumably, this recommendation would be effected by adding words to the text to make it read, "substantially impairs the value of the whole contract to the aggrieved party . . . ."

This textual change is probably consistent with the drafting intent. It was intended that the general test of subdivision 2-612(3) be similar to that for section 2-610.<sup>390</sup> The latter section contains

---

386 Cf. Comment on Section 7-9, *supra* note 367, at 5-6.

387 U.C.C. § 2-612 comment 6; Comment on Section 7-9, *supra* note 367, at 5-6, 6-7.

388 W. HAWKLAND, SALES AND BULK SALES 117-18 (A.L.I. 1958).

389 Prelim. Rpt., Part 6, Rec. A2.6(8)(B), *supra* p. 1174. Presumably the Study Group would recommend that the standard for rejection of an installment under § 2-612(2) also be judged subjectively.

390 U.C.C. § 2-610 comment 3. See Comment on Section 7-9, *supra* note 367, at 5.

language similar to that which would be added to the text of subdivision 2-612(3).

Yet, there is a danger in posing the question solely in terms of "subjective" or "objective" substantial impairment. The basis for judging substantial impairment under subdivision 2-612(3) is not and should not be the same as that of subdivision 2-608(1). Substantial impairment justifying cancellation of the whole contract is quite different from substantial impairment justifying revocation of acceptance of an installment under section 2-608.<sup>391</sup> Substantial impairment justifying cancellation, that is, "essential," "material," or "total" breach, involves a balancing of the interests of the aggrieved party against those of the breaching party.<sup>392</sup> Although the particular circumstances of the aggrieved party should be taken into account, the issue is not and should not be resolved solely on that basis. Thus, care must be taken not to upset the balancing of interests by confusing the test for cancellation in subdivision 2-612(3)<sup>393</sup> with the unabashedly subjective test for revocation of acceptance contained in section 2-608.

c. *Ability to Cure as Affecting Substantial Impairment of the Whole*

This is an issue that the Drafting Committee should consider even though it is not raised in the Preliminary Report.

Under subdivision 2-612(2), the buyer's rejection or acceptance of a defective installment explicitly turns on whether the default is curable. The test of substantial impairment of the whole contract in subdivision 2-612(3) does not explicitly turn on the curability of the default. Further, subdivision (2) is subject to subdivision (3). Thus, it might be inferred that curability and assurance of cure are irrelevant for purposes of determining whether there is a

---

391 Cf. Amendments to Section 7-9 (S.102) Breach in Installment Contracts 1, in the Llewellyn Papers, file J(IX)(2)(b).

392 Comment on Section 7-9, *supra* note 367, at 6 (quoting with approval *Helgar* analysis); 2 WILLISTON, *supra* note 365, at 750-54; 1 A. CORBIN, CORBIN ON CONTRACTS §§ 705-07, at 660-64 (1962); J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 358 (student 3d ed. 1988) (citing RESTATEMENT (SECOND) OF CONTRACTS § 241 (1979)). Peters does not disagree with the statement in the text. See Peters, *supra* note 352, at 225 n.79 (case law inquires closely into the needs of the parties and the availability of market alternatives).

393 What is said here in the text applies also to the Study Group's statement that the substantial impairment test for repudiation under § 2-610 is subjective. See Prelim. Rpt., Part 6, *supra* p. 1171-72.

substantial impairment of the whole contract under subdivision (3). This inference was not intended by the drafters.

Curability and assurance of cure are factors in determining whether there has been a substantial impairment of the whole contract. The drafters of section 2-612 approved and adopted the analysis of Judge Cardozo in *Helgar Corp. v. Warner's Features, Inc.*<sup>394</sup> as to what constitutes a breach of the whole contract. One of the factors Cardozo listed was, "if there is a reasonable assurance that [the default] will be promptly repaired . . . ."<sup>395</sup> Commentators generally agree that curability is a relevant factor.<sup>396</sup> To refute the inference that might be drawn from the text, the comments to section 2-612 should be revised to clarify the issue of curability under subdivision 2-612(3).

0

d. *Reinstatement of the Contract*

(1) The Study Group recommends amending subdivision 2-612(3) by replacing the phrase "reinstates the contract" with "waives the power to cancel."<sup>397</sup> The justification is that the new language is a more accurate statement of the law. The change seems merely to be a rephrasing because comment 6 to section 2-612 speaks of waiving the right to cancellation. It seems to border on a quibble. If, however, the present language has caused no problems and is adequate to express what is intended, it should be left alone.

Further, the rephrasing may complicate matters. It may prevent a seller who initially treats a breach as partial (by suing only with respect to past installments) from later suing for total breach if the buyer subsequently fails to pay for later installments. This consequence can arise from merger rules of pleading designed to prevent splitting a single cause of action into several suits. Consider the case of a seller who is confronted with the buyer's failure to pay an installment on time. Assume that the defect constitutes a

---

394 222 N.Y. 449, 119 N.E. 113 (1918).

395 Comment on Section 7-9, *supra* note 367, at 6 (quoting Cardozo, J.).

396 CORBIN, *supra* note 392, § 706; WHITE & SUMMERS, *supra* note 392, at 358; Lawrence, *Cure after Breach of Contract Under the Restatement (Second) of Contracts: An Analytical Comparison with the Uniform Commercial Code*, 70 MINN. L. REV. 713, 729-30 (1986); Travaglio, *The U.C.C.'s Three "R's": Rejection, Revocation and (The Seller's) Right to Cure*, 53 U. CIN. L. REV. 931, 999 n.372 (1984). Cf. 2 WILLISTON, *supra* note 365, § 467e; Peters, *supra* note 352, at 225 n.79 (case law on breach of the whole scrutinizes availability of market alternatives).

397 Prelim. Rpt., Part 6, *supra* p. 1174-75.

total breach,<sup>398</sup> but that the seller is uncertain as to this conclusion because of the vagueness of the standard for total breach. This seller may err on the side of caution and choose to continue the contract. The seller would then sue only for the payment then due. Assume further that subsequently, the seller makes another delivery, and the buyer again fails to make any payment. The seller then sues again, this time for total breach. The buyer could defend against this second suit by proving that the initial failure to pay constituted a total breach. Under merger rules, by initially suing for only part of the total breach, the second suit could be barred as an impermissible attempt to split the seller's initial cause of action for total breach into two suits.<sup>399</sup>

This concern prompted the drafters to state in subdivision 2-612(3) that initiating suit as to past installments reinstates the contract.<sup>400</sup> Their rationale for this solution, and apparently the

---

398 "Total breach" means a defect that substantially impairs the value of the whole contract under § 2-612(3).

399 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1292, at 3680-81 (rev. ed. 1937); RESTATEMENT OF CONTRACTS § 327 comment b (1932).

400 The language in question first appears in U.C.C. — Revised Uniform Sales Act § 100 (Third Draft, 1943) 41 (available in the A.L.I. Archives, Drawer 202) [hereafter R.U.S.A.—Third Draft, 1943].

The comment accompanying § 100 provides no explanation of the language. However, later events brought to light the reason for the language. In 1956 the N.Y. Law Revision Commission recommended the deletion of language in § 2-612(3) which read that suit only on past installments reinstates the contract. 1956 N.Y. Law Revision Comm'n Report 393. The reason for the recommendation is described in the research analysis of § 2-612 by John Honnold. 1-1955 N.Y. Law Revision Comm'n Report 543 ("Clause in subsection (3) 'or if he brings an action with respect only to past installments' would include an action for consequential damages for such installments and could produce anomalous results . . . [I]t was recommended that the clause be deleted."). See also Honnold, *supra* note 357, at 477-78.

The Article 2 Subcommittee of the Editorial Board resisted this deletion. In a report to that Board it stated,

The result [of deleting the language] would be that seller, having a single cause of action for total breach, has forfeited any further claim by trying to split his cause of action. This result is entirely proper in a case of unequivocal repudiation by the buyer, but not in a case where the seller is faced with a breach which might be found to be partial rather than total . . . .

U.C.C. Report No. 5 of the Subcommittee on Article 2—Draft, January 18, 1956, at 107-107a, in the Braucher Papers, file 26-2 (located in The Harvard Law School Library). See also U.C.C. Report to the Editorial Board of the Subcommittee on Article 2: Status of Sections and Answers to Unaccepted Recommendations 11 (Sept. 4, 1956), in the A.L.I. Archives, Drawer 198 ("The

reason for the reinstatement of contract terminology, was that by instituting the first suit the aggrieved party reestablished its duty to continue with performance, and, thus, legally converted the initial total breach into a partial breach. When our hypothetical seller institutes a second suit for total breach based on the subsequent failure of the buyer to pay, the merger rule would not apply to the second suit. Consequently, the seller could recover.<sup>401</sup>

The "reinstates the contract" language addresses the merger issue directly. Substituting "waiver of the right to cancel" is not as clear, for it leaves open the effect of the waiver on the discharge of the seller's duty to continue with its performance.<sup>402</sup>

Nevertheless, the drafters' concern with merger rules is not clearly expressed. Thus, the comments should be revised.

(2) The Study Group also recommends that the Drafting Committee consider adding to the text of section 2-612 a statement as to what conduct under section 2-610 waives the power to cancel.<sup>403</sup> The reason is that it makes sense to have a single subdivision that deals with waivers for all breaches of the whole contract. A concern that may underlie this recommendation is that subdivision 2-610(b) appears to give the aggrieved party more latitude than subdivision 2-612(3) to urge action inconsistent with cancellation without losing the power to cancel.<sup>404</sup>

There are several responses to this recommendation. First, section 2-610, not subdivision 2-612(3), was intended to cover repudiation.<sup>405</sup> To include language in one section that is applicable

---

proposal [of the N.Y. Law Revision Comm'n] as to subsection (3) would undesirably increase the risk that the aggrieved party might forfeit his claim for future installments in a case where it is doubtful whether the breach is partial or total."').

401 None of this reasoning is made clear in either the text or comments of § 2-612, possibly because it concerns a matter of procedure. Matters of procedure were not generally addressed in Article 2, apparently because several states had provisions in their constitutions requiring acts to deal with one subject. It was feared that an act dealing with both substance and procedure would violate these constitutional provisions. N.C.C.U.S.L., *Consideration in Committee of the Whole of the Revised Uniform Sales Act 136* (Aug. 18-22, 1942), *reprinted in* N.C.C.U.S.L., N.C.C.U.S.L. Archives Publications, microfiche 32.0-B(2) (Hein, 1983).

402 As to discharge of the aggrieved party's duty to perform, *see* RESTATEMENT (SECOND) OF CONTRACTS §§ 242, 237, 225 (1981).

403 Prelim. Rpt., Part 6, Rec. A2.6(8)(C), *supra* p. 1175.

404 Prelim. Rpt., Part 6, *supra* p. 1172.

405 *See supra* text accompanying note 386.

to another will only serve to confuse the scope of these two sections. Second, it may be that the aggrieved party should have more latitude to coax retraction and future performance from a repudiator than from one who has presently breached. It may be that the present breach is material because it cannot be cured. In any event, the Study Group's recommendation deserves very careful consideration before it is implemented.

#### 4. *Revocation of Acceptance Under Section 2-612*

The Study Group recommends revising the comments to section 2-612 to clarify that the remedy of revocation of acceptance is available under section 2-612, subject to the seller's right to cure under subdivision 2-508(1).<sup>406</sup> No reason is given for this recommendation.<sup>407</sup>

It is clear from the drafting history of section 2-612 that the buyer may revoke acceptance of an installment under subdivision 2-608(1)(a) if the seller's assurance of cure fails to materialize.<sup>408</sup> Beyond this situation, the drafting history is silent. Suppose that the buyer accepts an installment which it does not reasonably know to be defective. This buyer may have the right to revoke its acceptance under subdivision 2-608(1)(b). If so, the seller should have the right to cure the defect. This result would seem to follow from subdivision 2-608(3) and subdivision 2-612(2). However, it is the cure rules of subdivision 2-612(2), not subdivision 2-508(1), that apply in this situation. Further, the initial acceptance of an installment not known to be defective should not prejudice the buyer's right to cancel if the defect substantially impairs the value of the whole contract.<sup>409</sup>

#### 5. *Miscellaneous Study Group Recommendations*

The Study Group suggests that the Drafting Committee carefully consider Professor Peters' recommended revisions to section

---

<sup>406</sup> Prelim. Rpt., Part 6, Rec. A2.6(8)(D), *supra* p. 1175.

<sup>407</sup> The Study Group's citation to the Patterson article is puzzling. That article does not discuss revocation of acceptance. See Prelim. Rpt., Part 6 n.22, *supra* p. 1175. (discussing Patterson, *U.C.C. Section 2-612(3): Breach of an Installment Contract and a Hobson's Choice for the Aggrieved Party*, 48 OHIO ST. L.J. 177 (1987)).

<sup>408</sup> See R.U.S.A. - Third Draft, 1943, *supra* note 400, § 100(1)(b) ("[I]f in the latter case [when the seller gives assurance of cure] the non-conformity is not so cured, he may revoke any acceptance made after such assurances were given.'").

<sup>409</sup> Cf. U.C.C. § 2-612 comment 7 (1990). This was also pre-Code law.

2-612. These recommended revisions are discussed in the following paragraphs.

a. *Clarify the Various Options on Cure and Assurances*

Peters pointed out that subdivisions 2-612(2) and (3) create several distinctions, some of which turn on cure and assurances of cure, but fail to clearly resolve all of them.<sup>410</sup> This is a valid criticism, and the Drafting Committee should address this issue. The drafting history indicates that Peters' suggested resolution of the various options is essentially correct.

b. *Evenhanded Application to both Buyers and Sellers*

Here, Peters apparently refers to the fact that subdivision 2-612(2) provides detailed rules on a buyer's rejection or acceptance of an installment and does not adopt a perfect tender rule.<sup>411</sup> This criticism has already been discussed.<sup>412</sup>

c. *Reverse the Sequence of Subdivisions 2-612(2) and (3)*

Peters recommends reversing the sequence of subdivisions (2) and (3) so that any non-conforming tender is tested first for its effect on the whole contract, then, only if the contract survives, it should be tested for the effect of the non-conformity on the installment.<sup>413</sup> Theoretically, what Peters states is true. As a practical matter, however, the aggrieved party will almost always want to know first what its rights are as to the installment. This is so for several reasons: First, the more pressing question raised by a defective installment is whether the buyer must accept it. That question requires immediate response. Second, given the difficulty of predicting whether or not a non-conformity constitutes a substantial impairment of the whole contract, the aggrieved party will often be unsure and will thus proceed cautiously on the basis of the effect on the installment alone. The present sequence of subdivisions (2) and (3) thus represents the more practical sequence.<sup>414</sup>

---

<sup>410</sup> Peters, *supra* note 352, at 225-27.

<sup>411</sup> *Id.* at 224-25, 227.

<sup>412</sup> See *supra* text accompanying notes 359-76.

<sup>413</sup> Peters, *supra* note 352, at 227.

<sup>414</sup> The drafting history shows that the sequencing of § 2-612(2) and (3) was changed several times.

*[PRELIMINARY REPORT - 2-613]***N. INTRODUCTION: EXCUSABLE NON-PERFORMANCE.**

Sections 2-613 through 2-616 deal with the conditions and procedures for claiming excuse due to changed circumstances.<sup>25</sup> They also deal, in a limited way, with adjustments that should be made if the excuse claim is valid. These issues are related to but quite distinct from the risk of loss issues in §§ 2-509 and 2-510. Where the subject of the sale has been damaged or destroyed, risk of loss policy determines which party (or its insurer) bears the economic loss without deciding whether the residual obligations to deliver substitute goods or to pay are discharged. A seller in possession at the time of loss, therefore, may bear the risk of loss under § 2-509(3) and still be obligated under § 2-613 to deliver substitute goods.<sup>26</sup>

There has been much litigation over and even more commentary about §§ 2-613 through 2-616.<sup>27</sup>

**O. CASUALTY TO IDENTIFIED GOODS: § 2-613.****Rec. A2.6 (9).**

Although some revisions are recommended in the text and comments to § 2-613, these changes tend to conform to the results of the decisions rather than to break new ground.

**1. Standard for Excuse and Scope.**

Section 2-613 deals with the question under what circumstances the seller is excused where goods identified "when the contract is made. . . suffer casualty without fault<sup>28</sup> of either party before the risk of loss passes to the

---

25. Mistake claims, to the extent that they can be differentiated, deal with unknown circumstances existing at the time of contracting and are not within the scope of Article 2. See § 1-103.

26. A good example is *Bende & Sons, Inc. v. Crown Recreation, Inc.*, 548 F. Supp. 1018 (E.D.N.Y. 1982) where goods not identified at the time of contracting were destroyed in shipment before risk passed to the buyer. The court refused to excuse the seller under either § 2-613 or § 2-615(a).

27. Some representative articles include: *Wladis, Impracticability as Risk Allocation: The Effect of Changed Circumstances Upon Contract Obligations for the Sale of Goods*, 22 Ga. L. Rev. 503 (1988); *Halpern, Application of the Doctrine of Commercial Impracticability: Searching for the "Wisdom of Solomon,"* 135 U. Pa. L. Rev. 1123 (1987); *Prance, Commercial Impracticability: A Textual and Economic Analysis*, 19 Ind. L.J. 457 (1986); *Speidel, Court Imposed Price Adjustment Under Long Term Supply Contracts*, 76 Nw. U. L. Rev. 369 (1981); *Joskow, Commercial Impossibility, the Uranium Market and the Westinghouse Uranium Contracts Litigation*, 6 J. Legal Stud. 119 (1977).

28. Fault is defined as a "wrongful act, omission or breach. . . ." § 1-201(16).



buyer." The answer is where the contract "requires" these goods for its performance. Comment 1 equates "requires" to goods "whose continued existence is presupposed," which is like the "basic assumption" test in § 2-615(a), shorn of the "impracticability" requirement. Arguably, this equation is too broad.

Suppose, however, that goods "required" for performance were destroyed before or identified after the contract was formed. Comment 2 suggests that destruction after formation should be treated under § 2-613, and Comment 9 to § 2-615 suggests that either § 2-613 or § 2-615 could apply to cases of identification before the contract. In any case, there is uncertainty about the standards for excuse in a situation where the basic risk allocation question is constant.

(A) One solution is to redraft § 2-613 to cover all cases where identified goods are destroyed before risk of loss has passed to the buyer. It should be irrelevant when identification occurred or whether the goods conformed at the time of contracting. If such a redraft is done, the Drafting Committee should consider whether a clear test for excuse can be devised. One possibility, taken from § 263 of the Restatement, Second, is this: "When the existence of goods identified at the time of destruction is necessary for the contract, such destruction or deterioration before risk has passed as makes performance impracticable excuses the seller." If this revision were adopted, the Comments should illustrate its application.

(B) Another solution, preferred by a majority of the Study Group, is to repeal § 2-613 and redraft § 2-615 to provide the exclusive standard for excuse in all cases. Under this approach, the comments would be revised to illustrate the paradigm cases to which excuse should be granted. Also, the remedial consequences of excuse under § 2-613 should be integrated with similar provisions in § 2-615(c) to provide a more comprehensive statement.

## 2. Consequences of Excuse.

Section 2-613 also states the consequences of excuse when the loss is total (contract avoided) or when the loss or destruction is partial (buyer has limited options.)

(C) No revisions are recommended in these provisions. If, however, § 2-613 is merged with § 2-615, a new, expanded § 2-615(c) will be needed to provide a more comprehensive solution to post-excuse allocation issues.

## [TASK FORCE - 2-613]

## SECTION 2-613

The Study Group report recommends several substantive changes to section 2-613. One recommendation would alter the scope of the section and the standards for excuse.<sup>415</sup> An alternate recommendation, endorsed by a majority of the Study Group, would repeal the section and redraft section 2-615 to provide the exclusive standards for excuse.<sup>416</sup> It is difficult to evaluate these recommendations because the concerns that motivated the Study Group to make changes are not described in much detail.

One concern seems to be that it is arbitrary to excuse for destruction of goods identified at the time the contract was formed but not for destruction of goods identified after the contract had been formed. Nevertheless, this distinction accurately reflects both the Code and pre-Code sales law. Fairly early, sales law worked out the distinction between the sale of specific goods ("one bale of cotton marked FM305") and the sale of a quantity of goods ("one bale of cotton"). In the first case, destruction of the marked bale excused the seller from his duty to perform. In the second case, destruction of a bale that the seller had selected to deliver did not excuse him.<sup>417</sup> Various reasons have been advanced for this distinction.<sup>418</sup>

The reason most consistent with the results of the cases is impossibility of performance: it is impossible for the seller to tender conforming goods if the contract calls for a specific bale and that bale has been destroyed. Where the contract calls for one cotton bale, the seller's performance is not impossible, even though the bale selected by the seller has been destroyed, because other conforming bales exist. This is the distinction between "objective"

---

415 Prelim. Rpt., Part 6, Rec. A2.6(9)(A), *supra* p. 1191.

416 Prelim. Rpt., Part 6, Rec. A2.6(9)(B), *supra* p. 1191.

417 J. MURRAY, MURRAY ON CONTRACTS 650-51 (3d ed. 1990). The distinction is adopted in the Restatement (Second) of Contracts. See RESTATEMENT (SECOND) OF CONTRACTS § 263 illus. 1, 2 & 5, § 261 illus. 12 (1982).

418 See Wladis, *Impracticability As Risk Allocation: The Effect of Changed Circumstances Upon Contract Obligations for the Sale of Goods*, 22 GA. L. REV. 503, 535 & nn. 141-43 (1988) (enumerating these reasons for the distinction: (1) that it accorded with the presumed intent of the parties, (2) that the seller's performance had become impossible, and (3) that excusing the seller tended to divide the loss of the goods between the parties).

and "subjective" impossibility. The distinction has the virtue of simplicity. The parties can clearly allocate risk by contracting for specific goods, and a court can easily ascertain that allocation from their contract.

Such a clear distinction may well be preferred to one that turns on such nebulous concepts as "failure of a basic assumption" and "impracticability," especially when courts have been notoriously reluctant to grant excuse under the latter concepts. This distinction also roughly parallels the distinction between a producer who sells what it makes, and who, thus, often contracts for identified goods, and a jobber or middleman who buys for resale and who often contracts only for a quantity of goods.

In any event, the distinction is of great antiquity and neither Article 2 nor the Restatement (Second) of Contracts have sought to have it changed.<sup>419</sup>

Part of the Study Group's concern with section 2-613 may well be what it regards as inconsistent treatment among sellers who identify goods after the contract has been formed. Thus, the Study Group report refers to the uncertainty it believes is created by comment 9 to section 2-615. The comment states that excuse can be granted under either 2-613 or 2-615 for failure of crops to be grown on designated land.<sup>420</sup> The key fact in the situation described in the comment, however, is not that the seller identified the crops to the contract after it was formed by planting the crops. The key fact is that the land on which the crops were to be planted was designated when the contract was made. Thus, the seller is excused by crop failure precisely for the same reason that the seller of the marked cotton bale was excused: impossibility of performance. Once the crops planted on the designated land fail, no other conforming crops exist.

Chronologically, the development of the excuse described in comment 9 was effected by a logical extension of the excuse for destruction of specific goods.<sup>421</sup> In either case, the principle is the

---

419 The Article 2 provisions are § 2-613, which provides an excuse where the sale is of specific goods, and § 2-615. Section 2-615 (and its comments) are conspicuously silent on its application to the sale of a quantity of goods. *See supra* note 417 (citing The Restatement (Second) of Contracts provisions adopting the distinction).

420 U.C.C. § 2-615 comment 9 (1990).

421 Llewellyn described this extension in an early draft of the comment to the section that is now § 2-615. *See* Wladis, *supra* note 418, at 640-41 (quoting relevant text of that draft).

same: the goods described in the contract are unavailable and no other goods exist that can satisfy the contract description.

The Study Group may also be concerned that excuse under section 2-615 requires a showing of impracticability while excuse under section 2-613 does not. This distinction, though, is consistent with pre-Code law and present law. The cases involving the sale of specific goods or goods to come from a designated source grant excuse if the goods in question become unavailable, even though they are goods that are fungible.<sup>422</sup> This point is underscored by the comments to section 2-615. Whenever those comments discuss contracts for goods to be supplied from a designated source, they conclude that the seller should be excused if the designated source fails, without mentioning impracticability.<sup>423</sup> This lack of reference to impracticability is not puzzling if one remembers the principle underlying the excuse: impossibility of performance. No other goods satisfy the contract description. The seller's performance has become impossible and, therefore, impracticable. The omission of the impracticability requirement in section 2-613 and related comments does not mean that it is not required. Rather, it means that the requirement, by the nature of the cases, is satisfied.

Section 2-613 should be left as it is. There is presently no significant uncertainty or inconsistency between it and section 2-615. Combining section 2-613 with section 2-615 may actually cause uncertainty. Courts will puzzle over the reasons for including what are now section 2-613 cases within section 2-615, and may expand or contract the granting of excuse in undesirable ways. Eliminating section 2-613 will also cause renumbering of subsequent sections. This will complicate the task of legal research and should not be undertaken lightly.

[PRELIMINARY REPORT - 2-614]

P. SUBSTITUTED PERFORMANCE: § 2-614.

§ 2-614 provides special rules where an agreed "berthing, loading, or unloading" facility or an agreed "type of carrier becomes unavailable or

---

<sup>422</sup> See, e.g., *Paymaster Oil Mill Co. v. Mitchell*, 319 So. 2d 652 (Miss. 1975) (failure of seller's crop); *Dexter v. Norton*, 47 N.Y. 62 (1871) (marked cotton bales); *Campbell v. Hostetter Farms, Inc.*, 251 Pa. Super. 232, 380 A.2d 463 (1977) (failure of seller's crop); *Low's Ezy-Fry Potato Co. v. J.A. Wood Co.*, 26 A.D. Dec. 583, 4 U.C.C. Rep. Serv. (Callaghan) 483 (Agric. Dept. 1967) (same). Cf. *MURRAY*, *supra* note 417, at 651.

<sup>423</sup> U.C.C. § 2-615 comment 5 (discussing failure of exclusive source of supply and failure of production by an agreed source); *id.* comment 9 (discussing failure of crops to be planted on designated land).

*“the agreed means or manner of payment fails because of domestic or foreign government regulation.” Even though one party might otherwise be excused, it must accept a commercially reasonable or substantial equivalent.*

*The drafting of § 2-614 leaves much to be desired. Since no problems of substance appear to have arisen, however, no revision is recommended in the text of § 2-614.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-615]

**Q. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS:  
§ 2-615.**

**1. Scope of § 2-615.**

**Rec. A2.6 (10).**

*Two non-controversial revisions affecting the scope of § 2-615(a) are recommended by the Study Group.*

*(A) § 2-615(a) should apply explicitly to sellers and buyers. Thus, the first sentence might provide: “Delay in performance or a failure in whole or part to perform by a seller or a buyer. . . .” This simply confirms statements in the comments and holdings by the courts.<sup>29</sup> If so revised, all relevant excuse provisions must also be revised to accommodate the buyer.*

*(B) The first sentence of § 2-615(a) should be revised as follows: “Except so far as a seller or buyer may have assumed a greater or lesser obligation. . . .” This simply clears up an ambiguity in the existing text and incorporates the buyer as part of the picture.*

**2. The Basic Assumption Test.**

*Section 2-615(a) employs a unitary excuse standard, i.e., “basic assumption” plus “impracticability,” to govern two categories of “presupposed conditions.”*

---

<sup>29</sup> This revision would insure the same test of excuse for both seller and buyer without changing the case results. As a practical matter, courts have rarely excused the buyer's duty to accept and to pay for the goods because of changed circumstances and have almost never excused a buyer for so-called “frustration of purpose.” See, e.g., *Arabian Score v. Lasma Arabian, Ltd.*, 814 F.2d 529 (8th Cir. 1987); *Northern Indiana Public Service Co. v. Carbon County Coal Co.*, 799 F.2d 265 (7th Cir. 1986); *Restatement, Second, Contracts* § 265.

The first involves "capacity" or "force majeure" events, such as the failure of an assumed source of supply, strikes, act of government or "acts of God or the public enemy." In many cases, these events actually impede the ability to perform. Even without a force majeure clause, courts have been willing to grant relief in these cases, especially if the aggrieved party has made reasonable efforts to find a substitute performance.

The second involves market events, such as inflation, steep cost increases or fluctuating prices, that affect the "incentive" of one party to perform. Performance means a loss on the contract, because either the cost of performance will exceed the contract price or a market opportunity to sell or buy at a better price will be foreclosed by the agreed bargain. The courts, with one notable exception,<sup>30</sup> have been consistently unsympathetic to claims for excuse from "incentive" events.

(C) Despite uncertainty in and controversy over the "basic assumption" test, the Study Group's preference is to leave well enough alone. The test is consistent with that provided in the Restatement, Second and provides the courts with greater flexibility to grant excuse. The courts simply have not accepted that invitation. Nevertheless, the comments should be reviewed and revised to highlight the flexibility of the test and to reject some of the arbitrary limitations carried over from the common law.

### 3. Governmental Regulations and Orders.

A possible exception to the restrictive interpretation of § 2-615(a) involves governmental regulations or orders. Section 2-615(a) provides that non-performance is excused if "performance as agreed has been made impracticable. . . by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid." Under this language, the "compliance in good faith." requirement substitutes for the "basic assumption" test. See § 264 of the Restatement, Second.

The question is whether this test should provide broader relief than the usual "capacity" or force majeure event. Suppose, for example, that a public utility commission rejects a utility's request to "pass through" higher costs produced by unanticipated events in the performance of a long-term contract. Or suppose that, through extensive deregulation, the government has under-

---

30. *Aluminum Co. of America v. Essex Group, Inc.*, 499 F. Supp. 53 (W.D. Pa. 1980). See Goldberg, *Price Adjustment in Long-Term Contracts*, 1985 Wis. L. Rev. 527, 534-42. For a rare case excusing performance where an "incentive" event was covered in a force majeure clause, see *International Minerals & Chemical Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985).

mined the pricing assumptions upon which long-term contracts for the supply of natural gas are based. Are these "regulations or orders" with which a seller or buyer must comply and, if so, do they make performance of the contract "as agreed" impracticable?

The courts, giving this exception a narrow reading, have answered these questions "no." A government order making performance more expensive is treated as an "incentive" event, and the risk of governmental action is left on the disadvantaged party, unless a flexible pricing provision or a force majeure clause has been included in the contract.

(D) Most of the Study Group agree with this result. Nevertheless, we recommend that the Drafting Committee consider whether the governmental exception is too narrow and, if so, how it might be expanded.

#### 4. Relief if Excuse is Granted.

Sections 2-613(a) & (b), 2-615(b) & (c) and 2-616 provide a limited form of relief if some excuse is granted and set forth the procedures involved in claiming excuse.

(E) Except as required by any merger of §§ 2-613 and 2-615, no revisions are recommended in the text of § 2-615(b) and (c). There is no evidence of substantial problems in the interpretation or operation of these adjustment provisions.<sup>31</sup>

Beyond this, Article 2 is silent on post-excuse remedies or adjustment. Presumably, either the balance of the contract is discharged or the parties negotiate an agreed settlement and either terminate or continue performance. Although § 2-209(1) facilitates good faith adjustments, courts and commentators have concluded that Article 2 does not impose a duty to negotiate in good faith after changed circumstances unless agreed in the contract. Moreover, the courts and most commentators have rejected the argument that a court may, after concluding that some relief should be granted, impose an adjustment around which the parties may subsequently negotiate.

(F) A majority of the Study Group endorse these results. In short, negotiation and agreed adjustment short of total discharge should be left to the agreement of the parties. Nevertheless, the Study Group recognizes that agreement is a broad concept, that a bargain in fact to negotiate and adjust may be inferred from the commercial setting and that a policy favoring adjustment in some transactions,

---

31. See White, *Allocation of Scarce Goods Under § 2-615 of the UCC: A Comparison of Rival Models*, 12 U. Mich. J.L. Ref. 503 (1979).

*particularly long-term supply contracts, may facilitate efficiency and fairness. Accordingly, we recommend that the comments to § 2-615 be reviewed and revised to emphasize the broader potential of agreement in this important setting.*<sup>32</sup>

*A minority of the Study Group recommend a careful study of the proposition that Article 2 should foster if not require even broader duties to negotiate in good faith and to adjust in contracts where unanticipated disruptions have occurred.*

[TASK FORCE - 2-615]

## SECTION 2-615

The Study Group's distinction between "capacity" (or "force majeure") events and "incentive" events does not accurately describe the case law.<sup>424</sup> If the contract when made does not specify goods or source and does not contain a *force majeure* clause, most courts have not been willing to excuse the affected party.<sup>425</sup>

The Study Group makes two recommendations for subdivision (a), which it terms "non-controversial": (1) include buyers, and (2) permit the parties to assume a lesser obligation than that stated in section 2-615(a). Both of these recommendations are evaluated in the following paragraphs.

### 1. *Including the Buyer.*

This is not a change of substance. It merely confirms what is stated in comment 9 and the case law. The Study Group's recommendation, however, may be too facile. It assumes that the "impracticability of performance" standard is equally useful to define buyer excuse as well as seller excuse. This may not be the

---

32. See Hillman, *Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law*, 1987 Duke L. J. 1, 4-17 (1987) (developing such a model). See also Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 Cal. L. Rev. 2005 (1987) (discussing dynamics of post-event negotiation in long-term contracts).

424 Prelim. Rpt., Part 6, *supra* p. 1196.

425 See Wladis, *Impracticability as Risk Allocation: The Effect of Changed Circumstances Upon Contract Obligations for the Sale of Goods*, 22 GA. L. REV. 503, 600-25 (1988) (collection of sales impossibility and impracticability cases).



case. The Restatement, for example, employs different standards.<sup>426</sup> The Study Group might consider adding a subdivision to Section 2-615 that would cover buyer excuse and mimic the Restatement rule.

If buyers are to be explicitly included in the text, this change should be accompanied by revision of the comments to provide more guidance on when buyers are to be excused. Before doing this, however, the Study Group should decide whether the game is worth the candle. Given that existing law clearly permits the buyer to claim excuse under Section 2-615, but that courts virtually never excuse buyers, it may be better to leave things as they are.

2. *Permitting Sellers [and Buyers] to Assume Lesser Obligations than those Imposed by Section 2-615.*

Section 2-615 now permits the seller to assume a greater obligation than what is set forth in that section. By implication, it seems that the seller cannot lessen that obligation. This implication seems to be confirmed by comment 8.<sup>427</sup> Case law and commentators, however, take the position that the seller can lessen his obligation by agreement.<sup>428</sup> Some of these authorities limit such agreements to those that are commercially reasonable.<sup>429</sup> In sum, there is confusion over what the "greater obligation" language means.

That language first appeared in the Spring 1950 draft of the Code. The reason for the language is unclear.<sup>430</sup> The drafters seem

---

426 RESTATEMENT (SECOND) OF CONTRACTS § 263 (1981) (employing impracticability standard); *id.* § 265 (employing standard of substantial frustration of buyer's principal purpose in entering into contract).

427 "[T]his section itself sets up the commercial standard for normal and reasonable interpretation and provides a *minimum* beyond which agreement may not go." U.C.C. § 2-615 comment 8 (1990) (emphasis added).

428 *Interpetrol Bermuda Ltd. v. Kaiser Aluminum Int'l Corp.*, 719 F.2d 992 (9th Cir. 1983); *Eastern Airlines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957 (5th Cir. 1976); Hawkland, *The Energy Crisis and Section 2-615 of the Uniform Commercial Code*, 79 COM. L.J. 75 (1974); J. MURRAY, MURRAY ON CONTRACTS 639 & n.26 (3d. ed. 1990).

429 See *Interpetrol Bermuda Ltd.*, 719 F.2d at 992; Hawkland, *supra* note 428.

430 Hawkland, *supra* note 428, at 77-79. Chancellor Hawkland describes drafting history of the "greater obligation" language in § 2-615. He indicates that the language was used to emphasize that the seller could assume the risk of supervening events in ways other than by explicit agreement. *Id.* at 78. However, more than just this must have been intended. Comment 8 was amended by adding language that § 2-615 "provides a minimum beyond which agreement

to have been concerned with form contracts which often are over-drafted to give the drafting party maximum latitude to respond to a wide range of supervening events.<sup>431</sup> The effect of the "greater obligation" language apparently was to limit such over-drafted clauses to what is commercially reasonable. Thus, for example, a seller could not enforce a clause that excused his performance for events he caused;<sup>432</sup> nor could he walk away from a sale for failure of transportation facilities if the buyer were willing to take delivery of the goods at the seller's plant.<sup>433</sup>

It seems clear, however, that the drafters could not have intended to prevent the parties from tailoring a *force majeure* clause to their own circumstances, so long as the resulting clause operated in a commercially reasonable manner.<sup>434</sup> Nevertheless, this result is not very clear in either the text or Comments, thereby warranting some change. Any changes made should provide more explicit guidance to those who draft such clauses and to courts who construe them.

#### *Standards for Excuse*

The Study Group's recommendation to leave the "basic assumption" test alone, but to review and revise the Comments,<sup>435</sup> is sound. The Comments should be revised to provide more guidance on troublesome points. Karl Llewellyn put the section upon sound doctrinal footing: unforeseen supervening circumstances rendering performance commercially impracticable. The Comments

---

may not go." Further the "greater obligation" language replaced the phrase "unless otherwise agreed." *Id.* Under the Code at that time, if a section did not include the phrase "unless otherwise agreed" or similar language, the rules enunciated in that section were "mandatory and may not be waived or modified by agreement." ALI & NCCUSL, Uniform Commercial Code - Proposed Final Draft—Text Edition § 1-107 (Spring 1950), reprinted in 9 A.L.I. & N.C.C.U.S.L., Uniform Commercial Code Drafts 218 (1984).

431 Wladis, *supra* note 425, at 564 & n.232. See Comment on Section 6-3 (s.88) Merchant's Excuse by Failure of Presupposed Facilities or Conditions, reprinted in Wladis, *supra* note 425, at 648-49.

432 Cf. U.C.C. § 2-615 comment 5 (1990) (seller must employ all due measures to see that his source will not fail).

433 U.C.C. § 2-614(1) (1990).

434 U.C.C. § 2-615 comment 8 (1990) (referring to express agreements designed to enlarge upon or supplant provisions of § 2-615); *id.* § 2-207 comment 5 (referring to clause "enlarging slightly upon the seller's exemption" under § 2-615).

435 Prelim. Rpt., Part 6, Rec. A2.6(10)(C), *supra* p. 1196.

provide insight into some aspects of the doctrine, but not others. If the courts are to exercise more flexibility in excusing for supervening events, the comments need to provide additional guidance in several areas.

1. *Underlying Reason and Purpose of the Section.* The Comments should make clear that the section adopts the limited obligation theory of contract. That is, the parties ordinarily do not intend to allocate the risk of unforeseen events, thus leaving a gap in the contract. Should the unforeseen event occur, a court is to fill the gap. More specifically, the court should allocate the risk of the event based on what is fair under the circumstances, not on some supposed implicit agreement-based risk allocation which never occurred.<sup>436</sup>

2. *Unforeseen Events.* The Comments should clarify that the term "unforeseen" means something like "not expected." This meaning is what the drafters intended,<sup>437</sup> and it is consistent with one of the ordinary meanings of "unforeseen."<sup>438</sup> For example, the day before the Iraqi invasion of Kuwait, the occurrence of that event was not expected. It was, thus, "unforeseen" under section 2-615.<sup>439</sup>

---

436 As early as 1931, Llewellyn endorsed this approach:

Vastly different, as has often been pointed out, is the situation when we approach constructive conditions bottomed on the unforeseen. Not agreement, but fairness, is then the goal of inquiry. This holds of impossibility, and of frustration; it holds of mistake (whether urged to excuse or to ground a new promise of extra compensation). In all of these the question runs to the effect of unforeseen events or discoveries which destroy some presupposition of the deal. The effort is in essence to mark out a range and an apportionment of risks assumed; or more accurately, of risks to be imposed.

Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704, 745-46 (1931). See Wladis, *supra* note 425, at 567-69 (discussing limited obligation theory and its adoption by drafters of § 2-615). See also Farnsworth, *Disputes Over Omission in Contracts*, 68 COLUM. L. REV. 860 (1968) (developing the concept of unforeseen supervening events as a gap in the contract).

437 Wladis, *supra* note 425, at 573-76.

438 Cf. "Foresee . . . 1: to see (as a future occurrence or development) as certain or unavoidable: look forward to with assurance." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 890 (1981).

439 Though the invasion of Kuwait was unforeseen, whether a party is excused from performing its contract depends upon whether that event caused the impracticability. Thus, a seller of oil under a fixed price contract entered into shortly before the invasion would not necessarily be excused by the invasion and consequent rise in price of oil. Other events at the time of contracting (the OPEC production and pricing agreement, and Iraqi "tough talk" before the

Further, the test for what is "unforeseen" needs to be focused clearly on the information available to the parties at time of contracting, and whether, based on that information, a reasonable person would have expected the event to occur.

It may be necessary to use some term such as "unexpected" or "unanticipated" to effect this clarification. The term "unforeseen" is used in other areas of the law,<sup>440</sup> thus carrying with it some potentially undesirable legal baggage.

3. *Impracticability*. Some may raise the objection that the test of "unforeseen" described above is too easily satisfied and will undermine the institution of contract. There are two responses to this. First, that test more accurately reflects the allocation of risk intended by the parties. Under the definition of "unforeseen" presently used by courts when applying the "foreseeability" test, almost any event is foreseen. This results in courts enforcing obligations which no party in his right mind would have made had he expected that the event would occur. Second, the seller is not excused simply by showing that an event was "unforeseen." He must also demonstrate that his performance has become impracticable. To satisfy this test, the drafters intended that sellers were to be excused only for extreme cost increases.<sup>441</sup> This high standard in effect gives the benefit of the doubt to the party who wants the contract enforced.

The Comments should, however, be revised to direct the court to weigh the effect of its decision to excuse on both parties,<sup>442</sup> and, in close cases, to err on the side of enforcing the contract. These clarifications will result in the frequency of excuse being controlled largely by the impracticability prong of the test. Further, the court will be basing its decision on the effect of its decision upon both of the parties to the contract.

---

invasion) made it expected that oil prices would rise. On the other hand, if the invasion resulted in the seizure of a tanker full of oil which the seller had selected to fulfill the contract, the seller's delay in obtaining substitute oil might well be excused.

440 The concept of "foreseeability" is employed, for example, in limiting seller liability for consequential damages and in determining tort liability in negligence.

441 U.C.C. § 2-615 comment 4 (1990) ("Increased cost . . . due to some unforeseen contingency which alters the essential nature of the performance."). See Wladis, *supra* note 425, at 582-84 (commenting on the drafter's intent as to the high level of difficulty necessary to satisfy the impracticability standard).

442 Sometimes it will be necessary for a court to weigh the effect of its decision on non-parties as well, where, for example, a significant public interest is affected by the particular contract.

4. *Miscellaneous Study Group Recommendations.* The Study Group's recommendations concerning the scope of the governmental regulation excuse and the agreement to negotiate and adjust may not be necessary if the clarifications suggested above are introduced into the Comments. Nevertheless, if the Comments are to be revised to emphasize the broader potential of agreement to negotiate and adjust in the long-term contract, care must be taken to ground such an agreement upon an *actual* agreement of the parties as manifested by their words, deeds, or usage of trade.

[PRELIMINARY REPORT - 2-616]

R. *PROCEDURE ON NOTICE CLAIMING EXCUSE: § 2-616.*

*There are no stated procedures for claiming excuse under § 2-613. If excuse is granted, the legal effect and options of the buyer are stated in § 2-613(a) & (b).*

*Rec. A2.6 (11).*

*As previously noted, if § 2-613 is merged with § 2-615, the procedures and options when the loss to goods is partial or only a part of the seller's capacity to perform is affected must be integrated into a new subsection that incorporates the buyer and is coordinated with § 2-616. Other than this,<sup>33</sup> no revisions are recommended in the text of § 2-616.*

[TASK FORCE - NONE]

[PRELIMINARY REPORT - 2-701]

**ARTICLE 2, PART 7:  
REMEDIES**

A. *INTRODUCTION.*

*Article 2, Part 7 is a particularized application of the Code's general remedial policy contained in § 1-106. Sections 2-701 through 2-710 deal*

---

33. *As currently drafted, both § 2-613 and § 2-615 contemplate that if either all the goods are destroyed or all of the capacity prevented, the contract is discharged. An integrated subsection, in coordination with § 2-616, would have to state (1) the range of the seller's or buyer's options if excuse is partial, (2) the notice and other procedures to which the other party is entitled, and (3) the range of the other party's options if proper procedures are followed. The result is a procedure to facilitate a limited adjustment of contractual obligations after excuse is established.*

with seller's remedies, §§ 2-711 through 2-717 deal with buyer's remedies, and §§ 2-718 & 2-719 deal with agreed remedies between seller and buyer. Other provisions of Part 7 deal with the proof of market price, §§ 2-723 & 2-724, and the statute of limitations, § 2-725.

Many of these sections are frequently litigated, and the entire remedial structure has been subjected to extensive analysis and comment in the literature.<sup>1</sup> The issues are important, and there is considerable disagreement on what is a sound approach. This disagreement is reflected in the Study Group's analysis of Part 7.<sup>2</sup>

#### B. REMEDIES FOR BREACH OF COLLATERAL CONTRACTS NOT IMPAIRED: § 2-701.

Section 2-701 now deals with a minor issue<sup>3</sup>, the remedies available for breach of a "collateral contract," and, therefore, wastes an opportunity to state the basic remedial policies that should structure Part 7.

Rec. A2.7 (1).

We recommend that § 2-701 be retitled "Remedies in General" and the current text be relegated to a subsection. We recommend that new § 2-701 be redrafted and new comments prepared to accomplish the following objectives.

(A) The text should restate the basic remedial objective, i.e., protect the expectation interest, with its limitations on consequential and punitive damages, now expressed in § 1-106(1).<sup>4</sup> The new comments should state that, where appropriate, a court has power to protect reliance and restitution losses resulting from a breach, even if not explicitly recoverable under the text of Article 2.<sup>5</sup>

---

1. Two important, comprehensive analyses are Sebert, *Remedies Under Article Two of the Uniform Commercial Code: An Agenda For Review*, 130 U. Pa. L. Rev. 360 (1981)(hereinafter *Agenda*) and Peters, *Remedies For Breach of Contracts Relating to the Sale of Goods Under the UCC: A Roadmap to Article Two*, 73 Yale L.J. 199 (1963)(hereinafter *Roadmap*). See also R. Anderson, *Damages Under the Uniform Commercial Code* (1988).

2. For a brief overview, see *Agenda* at 364-67.

3. Only six cases have cited § 2-701.

4. The expectation interest is the aggrieved party's "interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed." Restatement, Second, Contracts § 344 (a). See generally, Sebert, *Punitive and Nonpecuniary Damages in Actions Based upon Contract: Toward Achieving the Objective of Full Compensation*, 33 UCLA L. Rev. 1565 (1986); Revision at 447-50(questioning the value of Article 2's "four-Tier" Damage Classification).

5. Under the Restatement, Second, Contracts, the reliance interest is the plaintiff's "interest in being reimbursed for loss caused by reliance on the contract, by being put in

(B) *The text should provide that a general principle of "mitigation" of damages applies, whether or not mitigation is built into a particular section, and that the defendant has the burden to establish that the plaintiff has failed to take reasonable steps to avoid the consequences of the breach.<sup>6</sup> The comments should state that a breach must be the cause in fact of any claimed loss and that the plaintiff has the burden of proving all direct and consequential damages with reasonable certainty.*

(C) *The text should state the general principle that remedies are essentially cumulative and any artificial doctrine of election is rejected. Two limitations on this principle should be expressed in general terms: (a) The choice of remedy should not exceed the expectation interest objective stated in § 1-106(1), but this depends upon the facts of each case, and (b) The choice of one remedy forecloses other remedies where there is a fundamental inconsistency or the aggrieved party has relied.<sup>7</sup>*

[TASK FORCE - 2-701]

## ARTICLE 2 - PART 7

### SECTION 2-701

The Task Force agrees with the Study Group's observations and recommendations regarding section 2-701, subject to the following:

1. We would delete any reference limiting consequential damages. We agree with the Study Group that section 2-710 should be amended to allow a seller to recover consequential damages subject to the appropriate limitations of foreseeability, certainty, and avoidance. Accordingly, any further limitation in section 2-701 would be both confusing and redundant.

---

as good a position as he would have been in had the contract not been made" and the restitution interest is the plaintiff's "interest in having restored to him any benefits that he has conferred on the other party." § 344 (b) & (c). For useful analysis, see R. Anderson, *Monetary Recoveries for Reliance and Restitution Under Article 2 of the UCC*, 22 U.C.C. L.J. 248 (1990); Gibson, *Promissory Estoppel, Article 2 of the UCC and the Restatement (Third) of Contracts*, 73 Iowa L. Rev. 659 (1988).

6. The presence of these principles would have saved Judge Posner extra work in *Cates v. Morgan Portable Building Corp.*, 780 F.2d 683 (7th Cir. 1979) (holding that defendant had duty to prove that plaintiff had failed to mitigate).

7. See Peters, *Roadmap* at 203-06. An implicit policy here controls opportunistic behavior by an aggrieved party making choices among available remedies.

2. Although we agree that the burden of proving that damages could have been mitigated should fall on the defendant, we note that section 2-715 defines consequential damages, in part, as those "which could not reasonably be prevented." By defining damages in this way, section 2-715 suggests that the plaintiff must prove an inability to mitigate as part of her proof of damages. This has led several courts to require, as a prerequisite to a recovery for consequential damages, that the buyer prove that the loss could not have been avoided by cover.<sup>443</sup> Arguably, the burden of proof regarding the lack of cover opportunities should be on the buyer because substitute goods are usually readily available on the market, and the buyer is usually best able to explain why she did not access those goods. Accordingly, although we agree that the burden regarding mitigation should generally rest on the defendant, the Task Force recommends that the Drafting Committee consider whether a special rule should be adopted that would require the buyer to prove an inability to cover as a condition to a recovery of consequential damages.

3. We do not understand what the Study Group means by its suggestion that a choice of remedy forecloses other remedies where "the aggrieved party has relied." Perhaps the reference is to reliance by the breaching party. If so, we suggest that the comments to such a revision give examples of how the injured party's choice of remedies might encourage detrimental reliance by the breaching party. The phrase "fundamental inconsistency" is also unclear in this context. We assume that the reference is to discarding a compensatory remedy in favor of one that will over compensate. If this is correct, then the phrase merely underscores the compensation mandate of section 1-106.

4. The Task Force recommends that the Drafting Committee consider including a comment to new section 2-701 stating that a seller or buyer may recover incidental or consequential damages, if properly proved, even though no general damages are recoverable by sellers under section 2-706, section 2-708, or section 2-709, or by buyers under section 2-712, section 2-713, or section 2-714. Since sections 2-710 and 2-715 only define incidental and conse-

---

<sup>443</sup> See, e.g., *National Farmers Org., Inc. v. McCook Feed & Supply Co.*, 196 Neb. 425, 243 N.W.2d 335, 19 U.C.C. Rep. Serv. (Callaghan) 821 (1976). See generally R. ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 11.21 (1988) (burden of proof).



quential damages, a plausible argument can be made that their recovery is predicated on proof of general damages by the aggrieved seller or buyer.<sup>444</sup> For example, since section 2-714(3) says that incidental and consequential damages "may also be recovered," does this imply a requirement of a general damages recovery under subsections (1) or (2) of section 2-714? Most courts have assumed not.<sup>445</sup>

[PRELIMINARY REPORT - 2-702]

C. SELLER'S REMEDIES ON DISCOVERY OF BUYER'S  
INSOLVENCY: § 2-702.

*Rec. A2.7 (2).*

*The Study Group recommends that the seller's power to reclaim goods from the seller or third parties, whether based upon the buyer's insolvency or the failure of a payment condition, be treated in one section, namely § 2-702. Accordingly, the following revisions are recommended in § 2-702.<sup>8</sup>*

*1. Section 2-702(1) provides that a credit seller may refuse to deliver except for cash where it "discovers the buyer to be insolvent" and may also "stop delivery under this Article (Section 2-705)."*

*(A) The Study Group recommends no revisions in the text of § 2-702(1). Rather, we recommended that it be moved to and stated as the first subsection of § 2-705. See discussion at Rec. A2.7 (4).*

*2. Section 2-702(2), as now drafted, deals only with the credit seller's power to reclaim goods from an insolvent buyer. It states the limited conditions on and the time for an insolvency reclamation. Section 2-702(2), however, does not explicitly deal with the reclamation rights of the seller, who delivers in exchange for a check which bounces. These are derived from § 2-507(2),*

---

<sup>444</sup> See *Associated Metals & Minerals Corp. v. Sharon Steel Corp.*, 590 F. Supp. 18, 20-21, 39 U.C.C. Rep. Serv. (Callaghan) 892, 895-96 (S.D.N.Y. 1983) (finding that § 2-710 merely defines the scope of "incidental damages" which are recoverable in connection with an action for: (1) the price, (2) damages flowing from the buyer's nonacceptance of the goods or repudiation of the contract, or (3) a resale of the goods resulting from the buyer's breach) (citing § 2-706(a)), *aff'd mem.*, 742 F.2d 1431 (2d Cir. 1983).

<sup>445</sup> See *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363, 25 U.C.C. Rep. Serv. (Callaghan) 1066 (9th Cir. 1978); *Lewis v. Mobil Oil Corp.*, 438 F.2d 500, 8 U.C.C. Rep. Serv. (Callaghan) 625, 796 (8th Cir. 1971); *Ralston Purina Co. v. Howell*, 254 So. 2d 911, 10 U.C.C. Rep. Serv. (Callaghan) 102 (Miss. 1971).

<sup>8</sup> See Revision at 436-41.

although the reclamation time limitations sometimes have been resolved by reference to § 2-702(2).

(B) Despite arguments to the contrary,<sup>9</sup> the Study Group recommends that both grounds for reclamation should be retained and integrated in a revised § 2-702(2). The revision should achieve the following objectives:

(1) Set forth the two common law bases for reclamation, which, in turn, dictate different time limitations.

When insolvency is the basis for reclamation, the "ten day" time limitation in § 2-702(2) should apply, with the following variations: A seller who has received a written misrepresentation of solvency from the buyer should have (1) a "reasonable time" to reclaim and (2) the benefit of a conclusive presumption of reliance on the misrepresentation. Also, a comment should state that payment by a check drawn against insufficient funds does not constitute a written misrepresentation of solvency.

When a conditional delivery by a "cash" seller is involved, the time for a reclamation demand should be a reasonable time after the seller discovers or should have discovered the fact of non-payment. Although this may be more or less than ten days, it is attuned to when the seller should know that there is a problem.

(2) In all other respects, the reclamation rights against the buyer should be the same.

3. Section 2-702(3) states that the "seller's right to reclaim. . . is subject to the rights of a buyer in ordinary course or other good faith purchaser under this Article." This version reflects the 1966 Amendment which deleted the phrase "or lien creditor" from the list of third parties whose rights might prevail over the reclaiming seller. The purpose of this revision was to resolve the priority dispute in favor of the seller.<sup>10</sup>

---

9. One line of argument is that the reclamation rights are rooted in common law exceptions to the policy against secret liens and have no place in a modern commercial code. Rather, the seller should be encouraged to create and perfect security interests in the goods. Another line of argument has to do with third parties who deal with the buyer without knowledge of any reclamation rights. Although they have more protection against reclamation than does the buyer, the risk that an uncommunicated reclamation demand will be received before the third party advances credit is real. Accordingly, common law reclamation should be rejected.

10. Without the phrase "or lien creditor," priority was determined under other state law, which generally favored the seller. See Braucher, *Creditor's Rights Under UCC, Article 2-Sales*, 67 *Comm. L.J.* 218 (1962). As of 1986, only 21 states and the District of Columbia had deleted the phrase "lien creditor." See Revision at 437.

Obviously, if the seller's reclamation demand is not timely, there is no need for § 2-702(3). But if the demand is timely, the question when the rights of BIOCB's or other GFP's arise is critical. If they arise before the reclamation demand is effective, then the third party's claim to the goods prevails and the seller is, in effect, unsecured.

(C) The Study Committee recommends the following revisions in § 2-702(3) or the comments.

(1) The reclamation rights against third parties, as detailed, should be the same for all sellers;

(2) A timely reclamation demand will be effective against the buyer. To prevail against third parties, however, the seller must recover possession of the goods before their rights attach.

(3) Only the rights of bona fide purchasers for value (including holders of security interests and lessees) and buyers in the ordinary course of business are protected. Other purchasers and lien creditors are subordinate to the timely reclamation demand.

(4) Third parties will be protected when they obtain interests in the goods that entitle them to possession as against the buyer. These rights to possession are determined under other sections, including §§ 1-201(9), 2-403 and 2-716.

(5) For purposes of § 2-403, a secured party under Article 9 may qualify as a good faith purchaser for value. The secured party's security interest, even if unperfected at the time the seller asserts a reclamation right, should prevail without proof of reliance unless the seller can establish bad faith. Thus, in the ordinary transaction, a perfected, after-acquired security interest that attaches when the buyer has rights in the goods will normally prevail, unless the seller is otherwise protected by state or federal law.

(6) The Study Group's tentative conclusion is that a reclaiming seller should not have a right to proceeds. If the goods cannot be reclaimed, the seller has only an in personam remedy against the buyer.<sup>11</sup>

(7) Since "lien creditor" is not defined in Article 2, we recommend that the Article 9 definition be reviewed for appropriateness and moved to Article 1 for general application.

These recommendations both clarify and tighten the rights of a reclaiming seller who has not perfected a security interest under Article 9. They are made with an eye on § 546(c) of the Bankruptcy Code but not with an intent to conform to § 546(c) as written. Rather, we would prefer to first

---

11. But see § 546(c) of the Bankruptcy Code.

"do it right" for Article 2 and then lobby for an appropriate revision of § 546(c).<sup>12</sup>

[TASK FORCE - 2-702]

## SECTION 2-702

The Task Force agrees with the Study Group regarding section 2-702.

[PRELIMINARY REPORT - 2-703]

### D. SELLER'S REMEDIES IN GENERAL: § 2-703.

Section 2-703 both states the catalogue of remedies that may be available to the seller and identifies the types of breach that trigger those remedies.

*Rec. A2.7 (3).*

*The Study Committee recommends the following minor revisions to § 2-703.*

*(A) Section 2-703 should be made "subject to" revised § 2-701;*

*(B) It is now a breach when the buyer fails to make a "payment due on or before delivery." But § 2-703 does not state what happens when the payment breach is "after delivery." Can the seller, nevertheless, sue for the price under § 2-709(1)? The answer is unclear, since § 2-703(e) seems to condition access to § 2-709 on a breach listed in § 2-703. If the seller is not entitled to the price, what other remedies are available? Is the seller limited to damages under § 2-708, as § 2-709(3) suggests,<sup>13</sup> or does the seller have access to the full catalogue of remedies in § 2-703? This dilemma should be resolved by revising § 2-703 to state "fails to make a payment due on, before or after delivery." It would then be clear that the seller could have access to § 2-709 or any other appropriate remedy listed in § 2-703.*

---

12. There was some sentiment to the contrary.

13. Accord *Trimble v. Todd*, 510 So.2d 810 (Ala. 1987). If the goods have been delivered and accepted, the seller will have every incentive to sue for the price under § 2-709(1)(a). But that remedy is permissive, not mandatory. Moreover, the buyer may default in payment after delivery but before acceptance. Unless § 2-703 applies here, it is doubtful that the seller could resell the goods under § 2-706(1), a remedy that depends upon satisfying the conditions in § 2-703. But see *Commonwealth Edison Co. v. Decker Coal Co.*, 653 F. Supp. 841 (N.D. Ill. 1987), holding that § 1-106(1) requires the seller to use § 2-709, if applicable, when § 2-708(2) would put it in a better position than full performance.

*In addition, the revision should clarify when the seller can cancel the contract for the buyer's failure to pay on time.<sup>14</sup>*

*(C) The test for a breach of the "whole" contract should be stated in the text of § 2-703, rather than by reference to § 2-612. Whether an "objective" or "subjective" definition of breach of the "whole" is stated depends upon a policy decision: How difficult should it be to cancel after a rejection, or revocation of acceptance or proper action under § 2-612? An objective test would make it harder to cancel than the subjective test.*

*(D) Subsection (a) should be revised to include "withhold delivery for insolvency of the buyer or stop delivery by any bailee." This revision implements the recommendation that § 2-702(1) be merged with § 2-705. Cf. § 2A-523.*

*(E) Subsection (e) appears to limit § 2-708 to breach by "non-acceptance." This limitation is inappropriate. The reference in § 2-703 to § 2-708 should be coextensive to the scope of § 2-708, i.e., "non-acceptance and repudiation."*

*(F) To implement our recommendation, made at A2.7(8), that a seller should be able to recover consequential damages, a new subsection should be added: "Recover incidental and consequential damages as hereafter provided (Section 2-710)."*

[TASK FORCE - 2-703]

#### SECTION 2-703

We agree with the Study Group regarding section 2-703. Please note, however, that several courts have held that the price action under section 2-709 is a mandatory remedy.<sup>446</sup> We believe that the price action should be a mandatory remedy in all cases in which the buyer retains the goods. We also believe that the Drafting Committee should consider providing a comment to section 2-709 to that effect.

[PRELIMINARY REPORT - 2-704]

#### **E. SELLER'S RIGHT TO IDENTIFY GOODS TO THE CONTRACT NOTWITHSTANDING BREACH OR TO SALVAGE UNFINISHED GOODS: § 2-704.**

*No revisions are recommended in the text of § 2-704.*

---

14. See Roadmap at 216-17 (concluding that the seller's power to cancel is "stated badly and without cross references. . .").

446 See R. ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 3.04 (1988).

## [TASK FORCE - 2-704]

## SECTION 2-704

The Task Force agrees with the Study Group that no revisions of section 2-704 are necessary. We do recommend, however, that the Drafting Committee consider adding a comment explaining what "effective realization" means in section 2-704(2).<sup>447</sup>

## [PRELIMINARY REPORT - 2-705]

*F. SELLER'S STOPPAGE OF DELIVERY IN TRANSIT OR OTHERWISE: § 2-705.*

*Section 2-705 is an important extension of a credit seller's right to "refuse" delivery upon the buyer's insolvency, § 2-702(1), and the seller's right to "withhold delivery" upon breach by the buyer. § 2-703(a).*

*Rec. A2.7 (4).*

*(A) We recommend that the text of § 2-702(1) be transferred to § 2-705 and renumbered as § 2-705(1). This improves the functional unity of the seller's "self-help" remedies and facilitates the redrafting of § 2-702 to deal exclusively with reclamation rights. The captions to these sections should be amended to reflect the changes.*

*No other revisions are recommended in the text of § 2-705.*

*Section 2-705(1) states the grounds for stoppage in transit, § 2-705(2) states how late the right to stop may be exercised against the buyer and § 2-705(3) states how the seller must notify the bailee and the duties of the bailee after proper notification. Although a fair amount of litigation has arisen under § 2-705, no problems of substance have been identified.<sup>15</sup>*

*An assumption here is that creditors of the buyer have no possessory rights (as we have defined that term) in the goods as long as the seller can stop delivery against the buyer. § 2-705(2). This is true for goods in the*

---

<sup>447</sup> See Anderson, *Damages for Sellers Under the Code's Profit Formula*, 40 Sw. L.J. 1021, 1035-39 (1986) (defining the term in the following manner: "If realization refers to the seller's lost expectation on the breached contract, the meaning is probably that the seller need only act reasonably and that in mitigating the loss it may look to its own interests as well as those of the breaching buyer." *Id.* at 1035.).

<sup>15</sup> Note that § 2-705(1) and (2) carefully distinguish between "carrier" and "bailee" but § 2-705(3) mentions only "bailee." The comments suggest that "bailee" is here used in the Article 7 sense, which includes a carrier. But since Article 2 does not define bailee, this intent should be clarified.

*seller's possession, and § 2-705 simply extends this concept to carriers and other bailees. This assumption, however, is not stated in the comments.*

*(B) We recommend that this clarification be made in the comments.*

*The right to stop delivery is, arguably, one example of a possessory security interest arising under Article 2. See § 9-113, Comment 1. It remains perfected (and with priority, we suppose) "so long as the debtor does not have or does not lawfully obtain possession of the goods." § 9-113. Presumably, perfection does not terminate where that buyer obtains possession from the bailee by fraud.<sup>16</sup>*

[TASK FORCE - 2-705]

## SECTION 2-705

We agree with the Study Group regarding section 2-705.

[PRELIMINARY REPORT - 2-706]

### G. SELLER'S RESALE INCLUDING CONTRACT FOR RESALE: § 2-706.

*Rec. A2.7 (5).*

*No revisions of substance are recommended in the text of § 2-706.*

*In most cases, an action for the price is the most efficient for the seller. The agreed price of the goods is obtained without lost volume, see § 1-106(1), and the post-breach expenses of retrieving, salvaging and disposing of the goods are avoided. The price remedy, however, is rarely available where the buyer breaches before accepting the goods. § 2-709(1).*

*In the absence of "lost volume," the resale remedy in § 2-706(1) is the next best thing if the goods are or can be identified.<sup>17</sup> On the one hand, the resale price may exceed the contract price and the seller is not accountable "for any profit made on the resale." § 2-706(6).<sup>18</sup> If, on the other hand,*

---

16. Peters concludes that, as a practical matter, a seller in possession or control of the goods can withhold delivery and cancel for breach without any right to "cure" by the buyer. Roadmap at 217-23. Should the buyer have a right to "cure" similar to that of the seller?

17. Goods, whether finished or unfinished, can be identified to the contract after breach, § 2-704(1), and resold. In fact, § 2-706(2) provides that it is "not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach."

18. Note, however, that a person "in the position of a seller" or a buyer who has rightfully rejected or justifiably revoked and resold under § 2-706 to protect a security interest, see § 2-711(3), must account for any excess over the security interest. This is the rule under Article 9. See § 9-504(2).

the resale price is less than the unpaid contract price, the seller may recover the resale/contract price differential, as adjusted for incidental damages and savings in § 2-706(1).<sup>19</sup> Assuming a realistic exception for "lost volume" cases, this measure of damages is satisfactory.

Lurking beneath § 2-706 are several continuing problems.

1. If the seller sues for damages under § 2-706(1), what statutory conditions must first be satisfied? In addition to giving the buyer in a private resale "reasonable notification of his intention to resell," § 2-706(3), the seller must resell in good faith and in a commercially reasonable manner. § 2-706(1). See also, §§ 2-706(2) & 2-706(4).

Although these conditions are complex and have given some courts trouble, we recommend no revisions.<sup>20</sup>

2. If the seller fails to satisfy the statutory conditions, what residual remedies are available? Comment 2 states that "failure to act properly. . . deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708." Some courts have held, however, that an attempt in bad faith to satisfy the conditions of § 2-706 should not permit the seller to recover § 2-708 damages that put it in a "better position" than full performance would have.

(A) This limitation, implicit in revised § 2-701, should be made explicit in the Comment.

3. If the seller satisfies the statutory conditions in § 2-706, may it still pursue damage remedies under § 2-708? The current answer is unclear, and the commentators disagree.<sup>21</sup>

(B) We recommend that, in the absence of lost volume, if the seller has notified the buyer and actually resold the goods in good faith and in a commercially reasonable manner, the seller is limited to damages as measured by § 2-706(1).<sup>22</sup>

---

19. A failure in the resale market means that the seller can recover the contract price under § 2-709(1)(b).

20. Peters argued that the conditions tended to support resale and should be treated as "evidentiary rather than directory." Roadmap at 256.

21. Compare Roadmap at 259-61 (both seller and buyer should have the same options) with Agenda at 380-83 (neither seller who resells nor buyer who covers should recover market damages higher than the resale or lower than the cover price).

22. The problem is to identify sellers who will not be made whole by an otherwise proper resale. The lost-volume seller is, in all probability, such a seller. Since it is difficult to establish whether the seller is in a lost-volume situation, the burden should be put on the buyer to prove that seller could not have made both sales "but for" the breach.



## [TASK FORCE - 2-706]

## SECTION 2-706

The Task Force agrees with the Study Group regarding section 2-706, subject to the following:

1. We recommend deleting section 2-706(3), which requires that the seller give the buyer in a private resale "reasonable notification of his intention to resell." Unlike a public resale, the notice requirement in a private resale serves no purpose. Further, the seller's failure to meet the technical notice requirement in section 2-706(3) has been strictly construed by the courts, resulting in many cases denying the resale remedy to the seller.<sup>448</sup> Such denials resulted even though the resale was in good faith and commercially reasonable.<sup>449</sup> Thus, a seller who has not pled and proven an alternative remedy may be denied any recovery.<sup>450</sup> We believe that the notice requirement protects no legitimate interest of the breaching buyer, but may work unfairly in delaying a seller from moving promptly to mitigate the loss caused by the breach. We note that there is no corresponding notice requirement in the buyer's parallel cover remedy and that the resale remedy under The United Nations Convention on Contracts for the International Sale of Goods also is not subject to a notice requirement.

2. We recommend that the term "auction sale" be substituted for the term "public sale" in section 2-706 because it more accurately describes what is intended.<sup>451</sup>

3. In reference to footnote 22 of the Study Group Report, we suggest that the buyer should carry the burden of proving that the seller "would" not have made both sales, rather than "could" not have made both sales. Many sellers operate at less than maximum capacity in order to maximize profits. These sellers will not make additional sales even though they have the capability of so doing. For purposes of computing damages, such sellers should be

---

448 See generally R. ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 4.10 (1988).

449 See *Lee Oldsmobile, Inc. v. Kaiden*, 32 Md. App. 556, 373 A.2d 270, 20 U.C.C. Rep. Serv. (Callaghan) 117 (1976).

450 See *Twin Bridges Truck City, Inc. v. Halling*, 205 N.W.2d 736, 12 U.C.C. Rep. Serv. (Callaghan) 381 (Iowa 1973).

451 See U.C.C. § 2-706 comment 4 (1990).

treated as at full capacity rather than as lost volume sellers, or the marginal profit of the added sale should be computed.<sup>452</sup>

*[PRELIMINARY REPORT - 2-707]*

*H. "PERSON IN THE POSITION OF A SELLER:" § 2-707.*

*No revisions are recommended in the text of § 2-707.*

*[TASK FORCE - 2-707]*

**SECTION 2-707**

The Task Force agrees with the Study Group that no revisions are necessary for section 2-707.

*[PRELIMINARY REPORT - 2-708]*

**I. SELLER'S DAMAGES FOR NON-ACCEPTANCE OR REPUDIATION: § 2-708.**

*Subject to § 2-708(2) and § 2-723 (proof of market price), § 2-708(1) provides a formula to measure damages for non-acceptance or repudiation: The "difference between the market price at the time and place for tender and the unpaid contract price" as adjusted upward for incidental damages and downward for expenses saved. In essence, the value of the bargain under § 2-708(1) is the unpaid contract price less the market price of the goods at the relevant time and place.*

*Section 2-708(2) is available to the seller "if the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done." and measures damages by a "components" approach: The seller may recover the "profit (including reasonable overhead) which . . . would have been made from full performance by the buyer." as adjusted upward for incidental damages and "due allowance for costs reasonably incurred and due credit for payments or proceeds of resale."*

*These subsections have given the courts problems and have provided a field day for the commentators. The issues are of two sorts: (1) When should each be applied, and (2) If a particular subsection does apply, what is the proper way to measure damages?*

---

<sup>452</sup> See Sebert, *Remedies Under Article Two of the Uniform Commercial Code: An Agenda for Review*, 130 U. PA. L. REV. 360, 389-90 (1981) (summarizing the analysis in Goetz & Scott, *Measuring Seller's Damages: The Lost-Profits Puzzle*, 31 STAN. L. REV. 323 (1979)).

1. *Section 2-708(1).*

*Rec. A2.7 (6).*

*The Study Group recommends several revisions in the text of and comments to § 2-708(1).*

*Application.*

*The formula in § 2-708(1) provides a rough measure of the gain in market terms prevented by the buyer's non-acceptance, repudiation or failure to pay. The measure is not precise and it does not pretend to compensate the seller for any investment (reliance) in the goods before the breach. Thus, § 2-708(1) creates a real risk of either-under-or-over-compensation. See § 1-106(1).<sup>23</sup>*

*One possible solution to this risk is to delete § 2-708(1) or to state explicitly that § 2-708(2) is the primary rather than a secondary remedy for wrongful rejection or repudiation. This solution, however, rejects an objective measure with deep historical roots for a more particularized measure, § 2-708(2), that is costly and sometimes difficult to apply.*

*Another solution is to clarify and limit the cases to which § 2-708(1) applies. Viewed realistically, § 2-708(1) is a surrogate for the resale remedy. Apart from the seller's reliance interest, the contract price/market price differential is similar to § 2-706(1), in that the market price is a substitute for an actual resale price. The risk of over or under compensation can be reduced, therefore, if the recovery on the two measures is roughly the same and potential reliance losses are removed from the equation.*

*(A) The Study Group recommends that § 2-708(1) be limited in application to three situations where the goods either have been resold or are available for resale: (1) The seller has resold in compliance with § 2-706 but has "lost volume;" (2) The seller has resold in good faith but otherwise has failed to comply with the conditions of § 2-706; and (3) The seller has not resold in fact, but has identified goods on hand or goods that were intended for the contract.<sup>24</sup> The Study Group rejects the application of § 2-708(1) to cases posing the greatest risk of under-compensation, i.e., where, at the time of breach, the seller is in the midst of and does not*

---

23. But see Roadmap at 257-61, where Peters justifies market damage formulas as statutory liquidated damages clauses.

24. See Agenda at 407-08. Professor Sebert would also apply § 2-708(1) where the seller tries but is unable to recover the price under § 2-709(1). This case is incorporated in situation (3), above.

*complete production, or of over-compensation, i.e., where the seller has no completed goods on hand.*<sup>25</sup>

*As an alternative, § 2-708(1) could be revised to state that damages should be measured in any way that puts the seller in the same position as full performance would have and that a common way to achieve that result is through the contract price/market price formula. In any event, the comments should provide illustrations to implement the general language.*

*Measure.*

*No revisions of substance are recommended in the measure of damages under § 2-708(1).*

*The measure of damages under § 2-708(1) is the "difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach." A breakdown of this formula indicates the following possible problems.*

*(a) The "market price" of the goods is "subject to" §§ 2-723 and 2-724, which deal with the establishment and proof of market price.*

*(B) The Study Group will recommend revisions in § 2-723(1).*

*(b) The clear language "time and place for tender" avoids proof problems when a claim for breach of an installment contract or breach by repudiation comes to trial after the time for performance has passed. In the installment contract, the seller must establish the market price at the time and place for tender of each installment. In the repudiation case, the same standard applies even though the seller exercised an option under § 2-610(a) to wait more than a commercially reasonable time for performance by the buyer.*<sup>26</sup>

---

25. This recommendation is consistent with Anderson, *Damages for Sellers Under the Code's Profit Formula*, 40 S.W. L.J. 1021, 1026 (1987), who argues that the "market formula hypothesizes that the seller will be able to resell the goods at the market price at the time and place for tender" in the absence of lost volume. It is also consistent with the view that § 1-106(1) should limit the choice of remedies that overcompensate. It also rejects the reasoning of *TransWorld Metals, Inc. v. Southwire*, 769 F.2d 902 (2d Cir. 1985), which held that where, at the time of breach, a middleman had made no forward contracts to secure the goods and was, in effect, betting on the market, it ought to have the full benefit, measured by § 2-708(1), of a successful bet. Perhaps a special case can be made for the "unhedged middleman," especially where the measure of lost profits under § 2-708(2) is difficult to prove because no forward contracts establishing the cost of performance have been made. See Comment, UCC § 2-714(1) and the Lost Volume Theory: A New Remedy For Middlemen, 77 Ky L.J. 189 (1988).

26. See *TransWorld Metals, Inc. v. Southwire Co.*, 769 F.2d 902 (2d Cir. 1985)(so holding).

*(C) The Study Group will recommend revisions in § 2-713(1) to achieve parity with the language and result under § 2-708(1).*

*Measurement of "market price" when a repudiation claim comes to trial before the time for performance has passed is determined under § 2-723(1).*

*(c) It should be clear that the deduction for "expenses saved in consequences of the buyer's breach" does not include costs that the seller would have incurred to procure or to manufacture the goods. Those savings are already worked into the formula in § 2-708(1). The proper expenses include other costs, such as transportation, that the seller would have incurred but for the breach.*

*(D) The Comments should be revised to clarify this point.<sup>27</sup>*

## *2. Section 2-708(2).*

### *Rec. A2.7 (7).*

*Due to a continuing controversy in the courts and the law reviews, several revisions in the text of and comments to § 2-708(2) are recommended.<sup>28</sup>*

### *Application.*

*Section 2-708(2) now applies "if the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done." Courts agree that, in most cases, it is the seller's burden to show inadequacy and that the case is made in two situations: (1) A resale would have produced or did produce "lost volume"<sup>29</sup> and (2) the seller, upon breach by the buyer, reasonably stopped performance before the goods were obtained or completed and salvaged. It is less clear whether*

---

*27. Suppose the contract required seller to deliver f.o.b. point of origin. At the time of breach, the seller had produced the goods but had neither prepared them for shipment nor delivered them to a carrier. After the breach, the seller decides not to resell and sues under § 2-708(1). The expenses saved are the costs not incurred in preparation and shipment. The costs incurred in producing the goods and subsequently disposing of them are irrelevant to § 2-708(1).*

*28. The Study Group has been influenced by the analysis and recommendations by Professor Sebert, Agenda at 383-407.*

*29. "Lost Volume" means that the seller, but for the breach, would probably have made two sales and thus two profits, one sale to the buyer and another to a third party. "Lost Volume," in its simplest form, exists when the seller has the capacity to make a second sale even though there is no breach in a market where the second sale probably would have been made. Many courts have found lost volume where the seller had capacity and in fact resold the goods after the breach.*

inadequacy exists where the seller has incurred no costs toward performance at the time of breach.<sup>30</sup>

(A) On the assumption that § 2-708(1) is a surrogate for resale and, thus, depends upon the seller having completed goods that could be resold, the Study Group recommends that § 2-708(1) or § 2-708(2) or the comments be revised to state when the seller may invoke § 2-708(2) and that those conditions, at a minimum, include "lost volume," incomplete and salvaged performance and cases where the seller has incurred no cost toward performance. In addition, a majority of the Study Group recommends that the Drafting Committee consider when, if ever, the buyer should be able to compel the seller to use § 2-708(2) because § 2-708(1), if applied, would put seller in a better position than full performance.<sup>31</sup>

*Measure.*

There has been much confusion and disagreement over how damages should be measured under § 2-708(2). Although the objective is to determine the "profit (including reasonable overhead)" that the seller would have made on the particular contract if performed, the method for making that determination is not clearly stated. This produces confusion and inconsistency when "lost volume" and salvaged performance disputes arise and are determined under the same standard.

(B) The Study Group recommends that a different measure of damages be devised for both the "lost volume" case and the "salvaged" performance case.

In the "lost volume" case, the seller has completed goods on hand that were or could have been resold. The total variable costs of performance have been incurred and are tied up in goods which have a market value.<sup>32</sup> The only question is the "profit" that would have been made on the sale.

The first step in measuring that profit is to subtract the total variable cost of performance from the contract price. This leaves a figure that includes profit and overhead. This figure should prevail unless the buyer shows either

---

30. In fact, market fluctuations may give a middleman and opportunity to claim higher damages under § 2-708(1) than under § 2-708(2). Some courts, invoking § 1-106(1), have required the seller to use § 2-708(2) when the damages under § 2-708(1) were higher and the seller had in fact hedged the market risk through forward contracting. E.g., *Union Carbide Corporation v. Consumers Power Co.*, 636 F. Supp. 1498 (E.D. Mich. 1986).

31. The Study Group supports the arguments made in *White, The Decline of the Contract Market Damage Model*, 11 U. Ark. Little Rock L.J. 1 (1988-89).

32. In short, the reliance interest represents variable costs invested in goods which could be resold.

that the variable costs incurred were unreasonable or the allocation of overhead to the contract was unreasonable.<sup>33</sup>

(C) The Drafting Committee should consider whether any further adjustments to the "gross profit" figure should be made because a second sale (the "lost volume") would not have been profitable. The possibility is suggested by economic analysis. If the answer is yes, then the scope of the adjustment and who has what burden of proof must also be addressed.<sup>34</sup>

This measure of damages, because it focuses only on lost profits, should not contain the language, now in § 2-708(2), "due allowance for costs reasonably incurred and due credit for payments or proceeds of resale."

In cases other than "lost volume," (i.e., "salvaged" performance) the seller may have incurred costs in partial performance before and "resold" for salvage after the breach.<sup>35</sup> In these cases, the court must determine both the "profit (including reasonable overhead)" that the seller would have made on full performance and should calculate any unreimbursed reliance costs incurred in part-performance. In addition, the seller will have some responsibility to take reasonable action after the breach to minimize reliance costs incurred before the breach. A different standard for measurement will, therefore, be required.

(D) The Study Group recommends the following measure of damages in cases of partial or no performance by the seller at the time of breach:

First, the seller should recover the "profit (including reasonable overhead)" measured by subtracting from the contract price the sum of the variable costs incurred prior to the breach and the variable costs that would have been incurred after the breach.<sup>36</sup> (KP - TVC).

---

33. For a discussion of the "overhead" problem, see Agenda at 403-07. Sebert correctly observes that although "there is no need to distinguish between profit and overhead, it is very important that the variable cost figure be accurate when measuring damages under the contract price less variable cost formula." *Id.* at 405.

34. See *R.E. Davis Chemical Corp. v. Diaonics, Inc.*, 826 F.2d 678 (7th Cir. 1987) (holding that the seller must prove that the second sale would have been profitable). Contra: Agenda at 391 (arguing that the burden should be on the buyer to prove that the second sale would not have been profitable because of "rising marginal costs"). See also Schlosser, *Damages For the Lost Volume Seller: Does An Efficient Formula Already Exist?*, 17 U.C.C. LJ 238 (1985) (arguing that no revisions are required to obtain efficient results).

35. Because the buyer has, in the exercise of "reasonable commercial judgment," elected to "cease manufacture and resell for scrap or salvage value. . .", § 2-704(2), there will be no completed goods on hand.

36. "Variable" as opposed to "fixed" costs are expenses necessary to perform the contract which would not be incurred but for the contract.

*The seller has the burden to prove the total variable costs, subject to proof from the buyer that the costs were unreasonable or the overhead allocation was unreasonable.*

*Second, the seller should also recover any reasonable variable costs incurred in part-performance before the breach. These reliance expenses should be adjusted downward for "any payments or proceeds of resale" received by the seller in salvaging or scrapping the part performance and any payments or proceeds that the buyer proves could have been obtained by reasonable efforts. This process captures the essence of the last clause in § 2-708(2), "due allowance for costs reasonably incurred and due credit for payments or proceeds or resale." It is part of the seller's "duty" to mitigate damages.*

*Third, this amount should be reduced for any payments made by the buyer under the contract and increased to reflect any incidental and consequential damages proved under § 2-710.*

[TASK FORCE - 2-708]

## SECTION 2-708

### A. Section 2-708(1).

The market formula for sellers is a hypothetical abstraction which at best approximates damages. In the significant majority of cases, a seller will be more accurately compensated by damages measured under section 2-706, section 2-708(2) or section 2-709. The application of section 2-708(1), thus, has great potential for abuse in over and undercompensating sellers.<sup>453</sup> The Task Force, thus, agrees with the Study Group that the application of section 2-708(1) should be limited. The limitation should apply to those situations in which damages cannot otherwise be accurately measured. We further agree that the goods must either have been resold or have been unavailable for resale. We question only the first of the three subset situations suggested at page 19 by the Study Group.

As a general proposition, we disagree that a "lost volume" seller should be entitled to damages under section 2-708(1). Such a seller should be restricted to the lost profit under section 2-

---

<sup>453</sup> See Anderson, *Pitfalls for Sellers and Buyers Under the Market Formula of Section 2-708*, 4 THE REV. OF LITIGATION 251, 257-58 (1985).



708(2).<sup>454</sup> We recommend that the first subset suggested by the Study Group be changed to read: "The seller has resold in compliance with section 2-706 and has 'lost volume,' but either cannot adequately prove damages under section 2-708(2), or damages under section 2-708(1) would be less than damages under section 2-708(2)."

We also disagree with the Study Group's alternative suggestion at page 20 that the market formula is a "common way" to achieve compensation for sellers. The market formula is rarely an accurate measure of compensation. The inadequacy of section 2-708(1) in the wide range of cases has been demonstrated by the Sebert, Peters and Anderson articles relied upon by the Study Group.

The Task Force strongly disagrees with the Study Group's suggestion that damages under section 2-708(1) should be measured at the time and place for tender in cases of anticipatory repudiation. We suggest that in anticipatory repudiation cases, damages should be measured within a reasonable time after the repudiation, when the time for awaiting performance by the buyer under section 2-610 has expired. We will suggest a similar rule for buyers under section 2-713.

As the Study Group has recommended, a seller seeking recovery under section 2-708(1) must either still have the goods at the time of trial or have resold them prior to trial. In the former case, the seller was either unable to resell or chose not to. If the goods were not reasonably resalable, the seller is entitled to an action for the price under section 2-709 and has no need for recovery under the market formula. If the seller chose not to resell but to retain the goods, that decision indicates speculation by the seller that retention was more valuable. That speculation must have been based on the value of the goods at roughly the time of repudiation, and that value best approximates the basis for the seller's damages. In effect, by not selling, the seller chose to purchase the goods herself at their market value at approximately the time of the repudiation.<sup>455</sup>

If, on the other hand, the seller has resold the goods in a commercially reasonable manner, then damages should be meas-

---

<sup>454</sup> We are thus in agreement with the Study Group in rejecting *TransWorld Metals, Inc. v. Southwire*, 769 F.2d 902, 41 U.C.C. Rep. Serv. (Callaghan) 453 (2d Cir. 1985), holding that a "lost volume" seller may recover under § 2-708(1) greater damages than would be allowed by § 2-708(2).

<sup>455</sup> See Anderson, *supra* note 453, at 267-72.

ured under section 2-706 or under a section 2-708(1) measurement that best approximates the resale price. If the resale was without undue delay, the latter measurement would be based on a market price near the time of repudiation. Of course, in an actual resale situation, a "lost volume" seller should recover under section 2-708(2), rather than under section 2-708(1). In sum, the Task Force rejects the Study Group's suggestion that repudiation damages should be measured at the time and place for performance because such a measurement would allow the seller to speculate unfairly at the buyer's expense, and because damages based on the market price near the time of repudiation best approximates the seller's actual loss.

B. *Section 2-708(2).*

The Task Force agrees with the recommendations of the Study Group subject to the following clarifications.

1. In the text of the Report at note 29, please note that *resales* do not produce "lost volume" but that *breaches* do.

2. In the text of the Report at note 31, we suggest that the Study Group's recommendation to the Drafting Committee include the suggestion that the buyer should be able to compel the seller to use section 2-708(2) in all cases in which section 2-708(1) would overcompensate the seller. We believe that any other result would contravene the liberal administration of remedies mandated by section 1-106.<sup>456</sup>

3. In the text of the Report at note 33, we find confusing the suggestion that a buyer might show that an "allocation of overhead to the contract was unreasonable," because this suggestion might be read to undermine the very basic proposition that fixed costs should always be included as part of the seller's lost profit recovery. In this vein, we suggest that the Drafting Committee consider

---

<sup>456</sup> We thus agree with cases such as *Union Carbide Corp. v. Consumers Power Co.*, 636 F. Supp. 1498, 1 U.C.C. Rep. Serv. 2d (Callaghan) 1202 (E.D. Mich. 1986) and *Nobs Chem., U.S.A., Inc. v. Kippers Co.*, 616 F.2d 212, 28 U.C.C. Rep. Serv. (Callaghan) 1039 (5th Cir. 1980) (holding that the basic philosophy of Article 2 is to put the aggrieved party in as good a position as if the other party had performed, but no better). We disagree with *TransWorld Metals, Inc. v. Southwire Co.*, 769 F.2d 902, 908, 41 U.C.C. Rep. Serv. 453, 460 (2d Cir. 1985) ("[N]othing in the language or history of subsection 2-708(2) suggests that it was intended to apply to cases in which 2-708(1) might overcompensate the seller.").

deleting the word "reasonable" in reference to overhead in the text of section 2-708(2). The reference is no doubt to situations in which costs that are normally fixed become variable because of circumstances unique to the breached contract.<sup>457</sup> For example, electricity and other utilities are normally overhead; but if a previously shut down plant is reopened solely for purposes of performing the breached contract, electricity and other utilities would then be regarded as variable costs.<sup>458</sup>

4. With respect to the discussion in the text of the Report at note 34 regarding unprofitable resales, we make the following two observations:

(a) As mentioned above, a seller should be considered to have "lost volume" only when she *would* (as opposed to *could*) have made both the sale under the breached contract and the resale. If the resale would have been unprofitable, it is unlikely that the seller would have sold.

(b) A lost volume seller who actually resells the goods at a loss should be restricted to a recovery under section 2-708(2) of the profit lost on the breached contract. A recovery under section 2-706 based on the unprofitable resale would overcompensate the seller by the amount of loss incurred on the unprofitable resale.<sup>459</sup>

#### [PRELIMINARY REPORT - 2-709]

#### J. ACTION FOR THE PRICE: § 2-709.

*No revisions are recommended in the text of § 2-709.*

*In the absence of acceptance by the buyer or passage of the risk of loss, § 2-709(1)(a), the seller cannot recover the contract price unless the goods are identified and the market failure standard in § 2-709(1)(b) is satisfied. On balance, this is an efficient solution (it does not force the buyer to take unwanted goods and puts the burden on the least-cost reseller, the seller). In most other cases (since the goods are completed), the damages in § 2-*

---

457 See 3 W. HAWKLAND, U.C.C. SERIES §§ 2-708, -338 to -339 (1986).

458 See *Vitex Mfg. Corp., Ltd. v. Caribtex Corp.*, 377 F.2d 795 (3d Cir. 1967). R. ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 5:12 (1988) (discussing the concept of "variable" overhead and the Code cases dealing with the problem). See *Universal Power Systems, Inc. v. Godfather's Pizza, Inc.*, 818 F.2d 667, 34 U.C.C. Rep. Serv. 2d (Callaghan) 1748 (8th Cir. 1987).

459 Anderson, *A Roadmap for Sellers' Damages Remedies Under the Uniform Commercial Code and Some Thoughts About Pleading and Proving Special Damages*, 19 RUTGERS L.J. 245, 257 n.28 (1988) (discussing proposition).

706(1) or § 2-708(1) will provide adequate protection. See § 2-709(3). See also Rec. A2.7(3)(B).

*If the seller is entitled to the price under § 2-709(1), the buyer may claim the goods intended for the contract or the net proceeds of any such goods resold by the seller. § 2-709(2). This is, in effect, the seller's version of specific performance, although the remedy clearly acts in rem. Compare § 2-716(1).*

[TASK FORCE - 2-709]

#### SECTION 2-709

The Task Force agrees with the recommendations of the Study Group regarding section 2-709.

[PRELIMINARY REPORT - 2-710]

#### K. SELLER'S INCIDENTAL DAMAGES: § 2-710.

*Upon occasion, a seller will claim consequential losses from failure of the buyer to accept the goods or to make a payment on time. Where payment is involved, the damages may include interest on existing loans that should have been retired or interest on new loans required to substitute for the promised payments. Most courts, relying on § 1-106(1), have held that a seller is not entitled to claim consequential damages under Article 2.<sup>37</sup>*

*Rec. A2.7 (8).*

*The Study Group recommends that § 2-710 be revised by adding a new § 2-710(1) that explicitly grants the seller a right to claim consequential damages. The revision might provide that consequential damages resulting from the buyer's breach include any loss resulting from general or particular requirements and needs of which the buyer at the time of contracting had reason to know and which could not be reasonably prevented by the seller.*

*If this recommendation is adopted, §§ 2-706(1), 2-708(1), 2-708(2) and 2-709(1) should be revised to say "together with any incidental and consequential damages as provided in this Article (Section 2-710)."*

---

37. E.g., *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358 (7th Cir. 1985)(Posner, J.); *Nobs Chemical, U.S.A., Inc v. Koppers Co.*, 616 F.2d 212 (5th Cir. 1980); *Sprague v. Sumitomo Forestry Co., Ltd.*, 104 Wash.2d 751, 709 P.2d 1200 (1985).

## [TASK FORCE - 2-710]

## SECTION 2-710

The Task Force agrees with the Study Group's recommendation that section 2-710(1) should be revised to grant the seller a right to claim consequential damages. We suggest that the Drafting Committee add comments to section 2-710 giving examples of types of consequential losses that a seller might suffer. We also suggest that the comments indicate that it is much rarer for a seller than a buyer to suffer consequential losses. Further, the comments might point out that, at the time of contracting, it is less likely that a buyer would have reason to know of the seller's potential for consequential loss than the seller would know of the buyer's consequential loss.

## [PRELIMINARY REPORT - 2-711]

**L. BUYER'S REMEDIES IN GENERAL; BUYER'S  
SECURITY INTEREST IN REJECTED GOODS: § 2-711.**

*Section 2-711 states the catalogue of remedies available to the buyer upon breach by the seller, identifies the types of breach that trigger the remedies and grants the buyer a security interest in goods in his possession after a rightful rejection or a justifiable revocation of acceptance.*

*Rec. A2.7 (9).*

*The Study Committee recommends the following minor revisions to § 2-711.*

*(A) Section 2-711 should be made "subject to" revised § 2-701;*

*(B) As in § 2-703, the test for breach of the "whole" contract should be stated in the text of § 2-711(1), rather than by reference to § 2-612. For an indication what that test might be, see Rec. A2.7(1);*

*(C) Section 2-711(2)(a), dealing with § 2-502, should be deleted if the Drafting Committee agrees that § 2-502 should be deleted;*

*(D) For clarity, a new subsection should be added which states that where the buyer has accepted the goods and is unable justifiably to revoke acceptance, damages may be recovered under § 2-714. Compare § 2A-508.*

[TASK FORCE - 2-711]

#### SECTION 2-711

The Task Force agrees with the Study Group regarding section 2-711.

[PRELIMINARY REPORT - 2-712]

#### *M. "COVER"; BUYER'S PROCUREMENT OF SUBSTITUTE GOODS: § 2-712.*

*In general, § 2-712 has worked well. It is a parallel remedy to resale, § 2-706(1), and will be used whenever the buyer needs goods in substitution for those not delivered by the seller and cannot obtain specific performance.*

*Section 2-712(3) provides that the "failure of the buyer to effect cover within this section does not bar him from any other remedy." These alternative remedies are available whether the buyer simply fails to cover at all or tries to cover but does not satisfy the conditions in § 2-712(2). The buyer, however, does not and should not have a duty to cover under § 2-712.*

*Rec. A2.7 (10).*

*The Study Group recommends that § 2-712(3) be revised to state that a buyer who effects a proper cover under § 2-712 should be barred from a remedy under § 2-713. This result is now implicit in § 2-711(1), and the explicit revision would be consistent with that proposed for § 2-706(1).<sup>38</sup> Furthermore, some of the Study Group believe that the damages of a buyer who attempts to cover but fails in bad faith to comply with § 2-712(1), should be limited to those that should have been awarded under § 2-712.*

[TASK FORCE - 2-712]

#### SECTION 2-712

The Task Force agrees with the Study Group regarding section 2-712.

Further, we agree with those members of the Study Group who suggest that damages for a buyer who attempts a bad faith

---

<sup>38</sup> *Sebert concludes that any revision "should make it clear that a buyer who covers cannot obtain market damages based on a market price higher than the actual cover price, and that a seller who resells cannot obtain market damages based on a market price lower than the actual resale price." Agenda at 382.*

cover should be limited to those that should have been awarded under section 2-712. Such limitation would be consistent with a similar limitation imposed by the courts on a seller's bad faith resale under section 2-706.<sup>460</sup> Given the potential difficulty of proof, however, the limitation should be suggested by the comments rather than made a part of the text of section 2-712.

[PRELIMINARY REPORT - 2-713]

N. BUYER'S DAMAGES FOR NON-DELIVERY OR REPUDIATION: § 2-713.

*Section 2-713, a parallel to § 2-708(1), is available only where the buyer is unable or unwilling to obtain specific performance under § 2-716(1) or "cover" under § 2-712.<sup>39</sup> Even so, there has been some criticism of § 2-713 and some isolated cries for its repeal.<sup>40</sup>*

*Rec. A2.7 (11).*

*(A) The Study Group recommends that § 2-713 be retained with the following revision:*

*A distinction should be made between a breach by non-delivery and a breach by repudiation where the time for measuring damages is involved. Currently, the time for both breaches is "when the buyer learned of the breach." This is inconsistent with the language of § 2-708(1) ("time and place for tender") and § 2-723(1) ("time when the aggrieved party learned of the repudiation"). Although the current language can be justified when the breach is by non-delivery,<sup>41</sup> a majority of the Study Group have concluded that the standard is too uncertain when the breach is by repudiation. Accordingly, except where § 2-723(1) is involved, (i.e., where the trial occurs before the time for performance is due), the majority recommend that when the seller repudiates, the market price for measuring damages under §*

---

<sup>460</sup> See *Coast Trading Co. v. Cudahy Co.*, 592 F.2d 1074, 25 U.C.C. Rep. Serv. (Callaghan) 1037 (9th Cir. 1978) (denying award of resale damages together under § 2-706 for failure to satisfy the elements of good faith and commercial reasonableness in suit against buyer for anticipatory repudiation).

<sup>39</sup> The remedies of specific performance or cover, if properly effectuated, are inconsistent with § 2-713(1) and should bar pursuit of that remedy.

<sup>40</sup> E.g., *Childres*, *Buyer's Remedies: The Danger of Section 2-713*, 72 Nw. U.L. Rev. 837 (1978).

<sup>41</sup> The language "learned of the breach" protects a buyer who does not learn that a seller has failed to deliver on a promised date until after that date has passed. See N.Y. Law Rev. Report 697-99 (1955).

2-713(1) should be determined at the time when and place where the seller agreed to tender delivery and that the same approach be applied to installment contracts.<sup>42</sup>

A minority favor a time for measurement that is closer to the time for breach. Favored by the courts and some commentators,<sup>43</sup> the critical point is the expiration of a reasonable time after the seller learns of the repudiation. This point limits damages to the time when the buyer should have covered and eliminates the possibility that the buyer will speculate on a shifting market.<sup>44</sup>

A lurking problem concerning the possible limitation of § 1-106(1) on the choice of § 2-713(1) remains. Suppose a middleman purchases goods for resale from a producer for \$1.00 per pound and immediately resells them for \$1.15 per pound. The producer fails to deliver when the market price rises to \$1.80 per pound at the time and place for tender. The middleman, however, does not cover and settles the contract with the resale buyer for a nominal amount. Should the buyer-middleman recover \$.80 per pound under § 2-713(1) or only the profit he would have made if the resale had taken place, some \$.15 per pound? Clearly, \$.80 per pound puts the middleman in a better position than full performance by the seller would have.<sup>45</sup>

(B) The Study Group recommends that the Drafting Committee consider whether the buyer (and, in similar situations, the seller) should be so limited in the use of § 2-713(1). This should be done in conjunction with the drafting of and the comments to the revised § 2-701.

---

42. This position is supported, in part, by the aggrieved party's difficulty in learning when the other party has repudiated. Rarely will the words or conduct of alleged repudiation be clear and unequivocal. A final answer may not be given until the trial. If so, it is unreasonable to tie the aggrieved party's damages to an uncertain time in the past, particularly where the breaching party created the uncertainty. This argument is less persuasive when the repudiation time is clear or the aggrieved party has smoked out a repudiation under § 2-609(4).

43. See *Cosden Oil v. Karl O. Helm Aktiengesellschaft*, 736 F.2d 1064 (5th Cir. 1984); Agenda at 372-80; Jackson, *Anticipatory Repudiation and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance*, 31 Stan. L. Rev. 69 (1978); Roadmap at 267. The market price is determined at a time no later than when the buyer should have covered. In repudiation cases, this would be at the expiration of a commercially reasonable time after the buyer learned of the repudiation. See § 2-610(a). Contra: J. White & R. Summers, *Uniform Commercial Code* § 6-7 (3d ed. 1988).

44. To avoid speculation, the buyer should be limited to the market price at the time it could reasonably cover (or resell) after learning of the repudiation.

45. *Allied Cannery & Packers, Inc. v. Victor Packing Co.*, 162 Cal.App.3d 905, 209 Cal. Rptr. 60 (1984) (buyer limited to profit that would have been made on resale).



## [TASK FORCE - 2-713]

## SECTION 2-713

The Task Force agrees with the recommendations of the Study Group that section 2-713 should be revised to distinguish between damages for a breach by non-delivery and those for a breach by repudiation. We disagree with the majority, however, and agree with the minority regarding the time and place where market price should be measured under section 2-713 in anticipatory repudiation cases. Although court decisions on this issue have differed, we note that recent decisions have not adopted the position recommended by the majority of the Study Group.<sup>461</sup> Further, to the best of our knowledge, among the many commentators who have addressed the question, only Professors Summers and White<sup>462</sup> side with the majority of the Study Group.

We recommend that the Drafting Committee revise section 2-713 to provide that in anticipatory repudiation cases, the market price for measuring damages should be determined at the time and place that the seller agreed to tender delivery *only if* the buyer can demonstrate a valid reason for not having covered. If the buyer could reasonably have covered following the repudiation, however, the market price should be measured at the time and place the buyer should reasonably have covered.<sup>463</sup>

We suggest that this recommendation satisfies the concern of the Study Group majority regarding the aggrieved party's difficulty in learning when or whether the other party has repudiated. If the aggrieved party's doubts in either regard were reasonable, those doubts could provide sufficient reason why the buyer did not cover and would justify measuring damages at the time and place for tender. We recommend no special rule regarding installment contracts. If the buyer could not cover with a reasonably acceptable substitute, installment contract damages should be measured at the times and places for tender as promised by the breached contract.

---

<sup>461</sup> See *Cargill, Inc. v. Stafford*, 553 F.2d 1222, 21 U.C.C. Rep. Serv. (Callaghan) 707 (10th Cir. 1977).

<sup>462</sup> See Prelim. Rpt., Part 7 n.43, *supra* p. 1230 (citing J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* § 6-7 (3d ed. 1988)).

<sup>463</sup> This recommendation is strongly influenced by the analysis of the court in *Cargill, Inc. v. Stafford*, 553 F.2d 1222, 21 U.C.C. Rep. Serv. (Callaghan) 707 (10th Cir. 1977).

Otherwise, damages should be measured based upon the price of the reasonably available cover contract.

We agree with the Study Group recommendation A2.7(11)(B) and suggest that the limitation applied by the court in the *Allied Canners*<sup>464</sup> case is consistent with the compensation limitation in section 1-106.

*[PRELIMINARY REPORT - 2-714]*

**O. BUYER'S DAMAGES FOR BREACH IN REGARD TO ACCEPTED GOODS: § 2-714.**

*Section 2-714 provides two measures of "direct" damages for the seller's breach where the buyer has accepted the goods, the first for "any non-conformity of tender," § 2-714(1), and the second for breach of warranty, § 2-714(2). Both are somewhat imprecise, and this imprecision is accentuated in § 2-714(2) where the difference in value test may be displaced where "special circumstances show proximate damages of a different amount." In essence, if "special circumstances" show that the difference in value test in § 2-714(2) will not put the buyer in as good a position as full performance, the court may develop an appropriate remedy under the more general standard in § 2-714(1).<sup>46</sup>*

*Rec. A2.7 (12).*

*The Study Group recommends no revisions in the text of § 2-714. We do recommend, however, that the comments be revised to illustrate by cases some of the lines that should be drawn. For example, the comments should confirm that the buyer's reasonable cost to repair is an appropriate way to determine the difference in value under § 2-714(2), even though that cost plus the value of the goods received may exceed the contract price.<sup>47</sup> Similarly, the com-*

---

464 *Allied Canners & Packers, Inc. v. Victory Packing Co.*, 162 Cal. App. 3d 905, 209 Cal. Rptr. 60, 39 U.C.C. Rep. Serv. (Callaghan) 1567 (1984) (limiting buyer's recovery to actual economic loss where buyer did not cover). See also *H-W-H Cattle Co., Inc. v. Schroeder*, 767 F.2d 437, 41 U.C.C. Rep. Serv. (Callaghan) 832 (8th Cir. 1985).

46. See Anderson, *Buyer's Damages for Breach in Regard to Accepted Goods*, 57 Miss. L.J. 317 (1987). According to Anderson, "special circumstances" have been found in claims for breach of warranty of title and for loss of crops of livestock caused by defective goods. In addition, the exception has been used to shift the time for measuring damages from acceptance to tender and to provide more compensation to a buyer who has over-mitigated damages. *Id.* at 56. See Roadmap at 268-75.

47. *Continental Sand & Gravel v. K & K Sand & Gravel*, 755 F.2d 87 (7th Cir. 1985).

*ments could identify prototypic cases where "special circumstances" show damages of a different amount.<sup>48</sup> Finally, the comments should clarify that "special circumstances" are not a condition to the recovery of consequential damages under § 2-715(2)(a).*

[TASK FORCE - 2-714]

## SECTION 2-714

The Task Force agrees with the observations and recommendations of the Study Group regarding section 2-714. We further recommend that the comments be revised to give examples of cases that are governed by subsection (1) of section 2-714.<sup>465</sup>

[PRELIMINARY REPORT - 2-715]

### *P. BUYER'S INCIDENTAL AND CONSEQUENTIAL DAMAGES: § 2-715.*

#### *1. Incidental damages.*

*Incidental damages include expenses incurred by the buyer after breach associated with a rightful rejection or "effecting cover." They also include "any other reasonable expenses incident to the delay or other breach." § 2-715(1). This catch-all category should cover expenses incurred to reduce or avoid consequential damages under § 2-715(2)(a).*

*Although the line between incidental and consequential damages may be difficult to draw, the Study Group recommends no revisions in the text of § 2-715(1).*

---

<sup>48</sup> In *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670 F.2d 1304 (3d Cir. 1982), the seller breached a warranty that a particular computer system would meet the buyer's particular purposes. There was evidence that another more expensive system would meet those needs. The court upheld a judgment under § 2-714(2) that the value of the goods as warranted could be measured by the value of the different system. The court rejected the dissent's argument that § 2-714(2) was limited to the value of "the" goods, i.e., the particular system delivered, "if they had been as warranted," but did not rely on the "special circumstances" exception. Arguably, that exception should apply, since the buyer's particular needs, which the seller agreed to meet, would not be met unless the value of the different system were calculated.

At least one member of the Study Group thinks that this case is "dead wrong."

<sup>465</sup> See Anderson, *Buyer's Damages for Breach in Regard to Accepted Goods*, 57 MISS. L.J. 317, 326-29 (1987).

## 2. Consequential damages.

*Consequential damages include losses resulting from the fact that the buyer is unable to use the promised goods for the period between breach and cure or replacement. These losses may be reliance expenditures incurred before the breach which cannot be salvaged or profits lost during the time in question which cannot be avoided by "cure" or cover. To recover consequential damages, the buyer must establish that the losses resulted from "general or particular requirements and needs of which the seller at the time of contracting had reason to know," § 2-715(2)(a), and prove them with reasonable certainty, see revised § 2-701. The seller, however, may be able to establish that the buyer could have reasonably "prevented" the losses by "cover or otherwise."*

**Rec. A2.7 (13).**

*No revisions are recommended in the text of § 2-715(2)(a). We endorse the current text's effort to relax the foreseeability requirement in exchange for an enhanced duty to "mitigate" damages and approve of the judicial interpretations of the section.*

*The Study Group supports the retention of § 2-715(2)(b), which permits the recovery for "injury to person or property proximately resulting from any breach of warranty." The nature of the loss should not determine when a buyer can sue for breach of warranty. But a buyer who asserts such a claim should be subject to the same defenses and limitations as a buyer who suffers only economic loss from breach of warranty. Rec. A2.3(8).*

[TASK FORCE - 2-715]

## SECTION 2-715

The Task Force agrees with the observations and recommendations of the Study Group and makes the following two additional recommendations.

1. We recommend that the Drafting Committee consider whether a recovery of incidental damages, like consequential damages, is subject to the general requirements of foreseeability and mitigation. Arguably, these requirements are implicit in the overarching reasonableness requirement in both section 2-715(1) and section 2-710.<sup>466</sup> It may also be implicit in the duty of good faith.

---

<sup>466</sup> See R. ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE §§ 2:18, 11:03, 11:05 (1988). Perhaps a comment to that effect would suffice.

2. We recommend that section 2-715(2)(a) be revised to make clear that the seller has the burden of proof on the issue of mitigation, i.e., whether the loss could be reasonably prevented by cover or otherwise. As noted above in our discussion of section 2-701, by defining consequential damages in terms of the mitigation requirement, section 2-715(2)(a) arguably requires the buyer to prove that the loss could not be reasonably avoided as part of her special burden of proving consequential loss. The recommended revision might read: "Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know, but recovery for such loss shall be reduced to the extent the seller can show that it could have been reasonably prevented by cover or otherwise . . . ."

*[PRELIMINARY REPORT - 2-716]*

*Q. BUYER'S RIGHT TO SPECIFIC PERFORMANCE OR REPLEVIN: § 2-716.*

*Despite the invitation in § 2-716(1) to expand the scope of specific performance and similar arguments in the literature,<sup>49</sup> there is no evidence in the reported opinions that courts have accepted the opportunity.<sup>50</sup>*

*Rec. A2.7 (14).*

*Because flexibility is built into § 2-716(1), the Study Group recommends no revision that would clarify or expand the power of a court to grant specific performance.*

*(A) We recommend, however, that § 2-716(1) be revised, in coordination with § 2-718(1), to expand the power of the parties to agree in advance for specific performance. A question to be decided by the Drafting Committee is whether every agreement for specific performance is enforceable or whether the parties, at the time of*

---

49. E.g., Greenberg, *Specific Performance Under § 2-716 of the UCC: A more Liberal Attitude in the Grand Style*, 17 *New Eng. L. Rev.* 321 (1981)(reviewing legislative history of § 2-716 and cases). See also Ulen, *The Efficiency of Specific Performance: Toward A Unified Theory of Contract Remedies*, 83 *Mich. L. Rev.* 341 (1984)(arguing that specific performance granted on "demand" would protect the promisee's subjective value in the contract, minimize consequential damages and reduce the costs of judicial administration and the parties' post-breach negotiations).

50. A possible exception is the use of specific performance to enforce long-term contracts for the supply of energy. See, e.g., *Laclede Gas Co. v. Amoco Oil Co.*, 522 F.2d 33 (8th Cir. 1975).

*contracting, must make a reasonable forecast that the goods are "unique" or that "other proper circumstances" will arise.*

*The history of the "replevin" right in § 2-716(3) is unclear<sup>51</sup> and, despite the modernization in most states of the replevin statutes, we have no evidence that replevin has been regularly used as an alternative to specific performance. Similarly, there is no evidence that replevin is needed to adequately protect the buyer.<sup>52</sup>*

*(B) Accordingly, a majority recommend that § 2-716(3) be deleted. The factors justifying replevin would, in most cases, satisfy the "special circumstances" requirement of § 2-716(1). As such, § 2-716(1), which is not limited to identified goods, appears to be a more complete goods oriented remedy. At the same time, the court can further protect the buyer by issuing a temporary injunction against breach.<sup>53</sup>*

#### [TASK FORCE - 2-716]

#### SECTION 2-716

The Task Force agrees with the observations and recommendations of the Study Group regarding section 2-716. As discussed below regarding section 2-718, we disagree with the Study Group's recommendation to expand the ability of the parties to agree to damages. We agree, however, with the recommendation to expand the party's ability to agree in advance to specific performance. These positions are not inconsistent because specific performance is always a compensatory remedy. Thus, an agreement for specific performance does not conflict with the compensation mandate of section 1-106. An agreement by the parties to provide for other than compensatory damages, however, directly conflicts with section 1-106.

---

51. See U.S.A. § 66, which provided: "Where the property in the goods has passed to the buyer and the seller wrongfully neglects or refuses to deliver the goods, the buyer may maintain any action allowed by law to the owner of goods of similar kind when wrongfully converted or withheld."

52. See Roadmap at 233-39, where Peter's questions the utility of replevin, particularly where the buyer is in competition with creditors of the seller. See also Report of the Law Revision Commission 576-79 (replevin right inconsistent with Code's theory about property).

53. An advantage of replevin, which asserts that the seller is wrongfully withholding goods in which the buyer has a property interest, is that the buyer may obtain possession after a hearing in a shorter period than under § 2-716(1). The disadvantages are that the seller can appeal, the buyer must post a bond and the power of the court to give complete relief is limited.

[PRELIMINARY REPORT - 2-717]

**R. DEDUCTION OF DAMAGES FROM THE PRICE: 2-717.**

*No revisions are recommended in the text of § 2-717.*

[TASK FORCE - 2-717]

**SECTION 2-717**

The Task Force agrees with the Study Group that no revision of section 2-717 is necessary.

[PRELIMINARY REPORT - 2-718]

**S. LIQUIDATION OR LIMITATION OF DAMAGES;  
DEPOSITS: § 2-718.**

**1. Section 2-718(1).**

*The Study Group concluded that commercial parties, at least, should have more power to fix by agreement the amount or method of calculation of damages in advance of breach. Their agreement should be enforceable regardless of whether the actual damages exceed or are less than the amount fixed in the agreement.<sup>54</sup>*

*Rec. A2.7 (15).*

*(A) The Study Group recommends that the test in § 2-718(1) for determining the reasonableness, ex ante breach, of the damages be retained.<sup>55</sup> The last sentence of § 2-718(1), however, should be deleted. This appears to give a court power, ex post breach, to reject damages that were a reasonable forecast at the time of contracting. Furthermore, the last sentence says nothing about the treatment of damages that are unreasonably small. See Comment 1. If the intention of the parties is indeed to fix damages based upon a reasonable forecast rather than attempting to limit liability regardless of that*

---

<sup>54</sup>. See generally, Anderson, *Liquidated Damages Under the UCC*, 41 Sw. L.J. 1083 (1988). The issue has been avoided in so-called "take or pay" disputes, where the clause has been treated as providing for alternative performance of the bargain rather than a remedy for breach. See *Universal Resources Corp. v. Panhandle Eastern Pipe Line Co.*, 813 F.2d 77 (5th Cir. 1987).

<sup>55</sup>. Accord § 2A-504(1).

*forecast, all deviations of the agreed damages from actual damages should be validated under the reasonable forecast test.*<sup>56</sup>

*The Study Group also recommends that the comments be revised to clarify that an agreed formula or method for calculating damages that survives the reasonable forecast test should also be enforced.*

## *2. Other Subsections of § 2-718.*

*Section 2-711(1) provides that where the seller has breached, the buyer, in addition to other remedies, may recover "so much of the price as has been paid." Section 2-718(2)(a) establishes a limited right to restitution by a breaching buyer who has pre-paid an amount which exceeds the seller's rights under an enforceable liquidated damage clause, and § 2-718(3) provides other grounds for the seller to further reduce the buyer's restitution claim. These sections virtually exhaust the buyer's explicit restitution rights under Article 2.*<sup>57</sup>

*The discordant note is § 2-718(2)(b), which establishes, in effect, a statutory liquidated damage clause for the seller. Even though there is no enforceable liquidated damage clause, the buyer can only recover in restitution an "amount by which the sum of his payments exceeds. . . twenty per cent of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller." The history of this subsection is murky (it was part of the New York Sale of Goods Act)<sup>58</sup> and its current utility is dubious.*

*(B) The Study Group recommends the deletion of § 2-718(2)(b) and the integration of § 2-718(2) and (3) into one subsection.*

*(C) Although no other revisions in § 2-718 are recommended, we suggest that the Drafting Committee consider the desirability of drafting a separate section dealing with the restitution claims of both seller and buyer and the recoupments that might be available.*

---

56. This approach was taken in *California & Hawaiian Sugar Co. v. Sun Ship, Inc.*, 794 F.2d 1433 (9th Cir. 1986)(enforcing a clause liquidating damages for delay at \$4,000,000 where the net actual damages amounted to only \$368,000).

57. See *Barco Auto Leasing Corp. v. House*, 202 Conn. 106, 520 A.2d 162 (1987), where Justice Peters, in dictum, suggested that a breaching seller might, by analogy, use § 2-718(3)(b) to reduce the buyer's claim for a price refund by the value to the buyer of the use of the goods between rejection and return.

58. The origin of § 2-718(2)(b) is Section 145-a of the New York Personal Property Law, enacted in 1952. See Report of the Law Revision Commission 704-05(discussing reasons for and application of § 145-a).



## [TASK FORCE - 2-718]

## SECTION 2-718

Although the Task Force agrees with recommendations A2.7(15)(B)&(C) regarding "other Subsections of section 2-718," we strongly disagree with recommendation A2.7(15)(A). We believe that a court should have the "power, ex post breach, to reject damages that were a reasonable forecast at the time of contracting." The recommendation of the Study Group would make liquidated damages provisions risk allocators similar to warranty disclaimers and remedy limitations. This, in many cases, would be contrary to the intention of the parties who did not intend to allocate risks, but merely estimated damages that they assumed would be uncertain in amount and difficult to calculate. If damages do turn out to be readily ascertainable, the parties were mistaken in their assumption. In such cases, performance of liquidated damage provisions should be excused as in any other case involving fundamental, unforeseen circumstances.<sup>467</sup>

Further, by allowing a reasonable forecast to control over readily calculable actual damages, the Study Group's recommendation would allow the parties to contract for penal damages in contravention of the compensation mandate of section 1-106. Most commentators who have argued in favor of such a rule have suggested that it is justified because aggrieved parties are rarely fully compensated by standard remedies. Particular concern is often expressed for the fact that, in most states, the aggrieved party is not compensated for attorney fees and cost of litigation. We suggest that if this is a primary concern, the Drafting Committee might consider a provision allowing a prevailing party to recover such fees and costs. A few states have statutes which allow this type of recovery for the prevailing party in a breach of contract action.<sup>468</sup>

---

467 See 5A CORBIN ON CONTRACTS § 1063, at 362-64 (1964). See also RESTATEMENT OF CONTRACTS § 339 comment c (1932):

If the parties honestly but mistakenly suppose that a breach will cause harm that will be incapable or very difficult of accurate estimation, when in fact the breach causes no harm at all or none that is incapable of accurate estimation without difficulty, their advance agreement fixing the amount to be paid as damages for the breach is within the rule stated in Subsection (1) and is not enforceable.

468 See TEX. CIV. PRAC. & REM. CODE ANN. § 38.0001 (Vernon 1986).

We further suggest that the Study Group's recommendation would have the unfortunate effect of encouraging wider use of liquidated damage provisions in goods transactions, thereby increasing litigation under section 2-718. There have been comparatively few appellate level liquidated damage cases under the present version of section 2-718(1). This is no doubt because most goods have regularized markets, and a breach of contract for their sale rarely produces uncertain actual damages. There is concern that implementation of the Study Group's recommendation would encourage the argument in a large number of cases that the forecast of liquidated damages was reasonable, regardless of the certainty of the actual damages.

If the Drafting Committee agrees with the Study Group, however, that liquidated damage provisions should be treated as risk allocators, we suggest that this result can be better accomplished by a provision stating simply that damages may be liquidated by the parties in any amount that is not unconscionable. Although somewhat iconoclastic, such a provision would more clearly accomplish the objective and would, in all probability, produce less litigation.

Finally, we note that the Study Group's recommendation makes no exception for consumer transactions. We suggest that if the Study Group's recommendation is implemented, an exception should be made for consumer transactions. Otherwise, there is the risk that consumers will regularly become subjected to penal damages by standardized contract terms over which they have no real bargaining leverage.

Instead of the Study Group's recommendation, the Task Force recommends that section 2-718(1) be revised by deleting the words "the anticipated or" from the provision. The enforcement of liquidated damage provisions would thereby be restricted to situations in which the assumptions of the parties at the time of contracting turn out to be true, i.e., when actual damages caused by the breach are uncertain in amount and difficult to calculate.

*[PRELIMINARY REPORT - 2-719]*

*T. CONTRACTUAL MODIFICATION OR LIMITATION OF REMEDY: § 2-719.*

*Rec. A2.7 (16).*

*The following revisions are recommended in the text of and comments to § 2-719.*

1. *Scope of agreed limitation.*

Section 2-719(1), which is expressly subject to § 2-718 and subsections (2) and (3) of § 2-719, states that the agreement may "provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article." but does not state how far the parties may go to "contract out" of all remedies.<sup>59</sup>

Assuming that the limited or modified remedy is agreed to be exclusive, § 2-719(1)(b), § 2-718(1) would apply only if the agreement was intended to liquidate rather than to limit damages. The controls in other subsections to § 2-719 are limited and do not answer the "how far" question. The only hint of an answer is language in Comment 1 that the parties are entitled to "minimum adequate" remedies or a "fair quantum" of remedy.

(A) *The Study Group recommends that the Drafting Committee consider whether more precision can be given to the "fair quantum" limitation and whether that should be expressed in the statute rather than the comment.*<sup>60</sup>

2. *Failure of Essential Purpose: § 2-719(2).*

Assuming that the parties have agreed to an exclusive remedy, § 2-719(2) has been the subject of frequent litigation and commentary.<sup>61</sup> The subsection provides: "Where the circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided by this act." The principal issues in the cases are (1) when does the remedy "fail of its essential purpose" and (2) if the remedy fails, is the aggrieved party permitted to pursue all or just some of the remedies "as provided by this Act."

Issue (1) must be decided on the facts of each case, e.g., what was the agreed remedy, what purpose did the parties intend for that remedy, what

---

59. Agreement may be used to limit liability in three ways: (1) To limit the duty of one party to perform and, thus, the potential scope of breach. See § 2-316(2) permitting the "disclaimer" of implied warranties. (2) To liquidate the actual damages expected to arise from a breach, § 2-718(1). (3) To limit the remedy for any breach, regardless of the actual damages caused, § 2-719.

60. For a possible line of attack, see Kniffin, *A Newly Identified Contract Unconscionability: Unconscionability of Remedy*, 63 *Notre Dame L. Rev.* 247 (1988). See also § 2A-503(2).

61. See, e.g., Foss, *Failure of Essential Purpose: An Objective Approach*, 25 *Duq. L. Rev.* 551 (1987); Mather, *Consequential Damages when Exclusive Repair Remedies Fail: UCC § 2-719*, 38 *S. Car. L. Rev.* 673 (1987); Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 *Calif. L. Rev.* 28 (1977).

circumstances impaired or caused that purpose to fail. Most courts have done a good job in applying § 2-719(2).<sup>62</sup>

*No clarification is required in the text of the statute.*

Issue (2) arises most frequently where, under the agreement, a seller has made a limited express warranty that the goods are free from defects in material and workmanship and agreed to repair or replace defective parts during a stated period as an exclusive remedy and, also, has disclaimed all other warranties, express or implied and excluded consequential damages. A defect within the express warranty occurs and the seller is unwilling or unable to "cure." This, of course, is a breach and most courts have concluded that the limited remedy has "failed of its essential purpose." Invariably, the buyer has argued that the failure entitles it to recover direct and consequential damages under Article 2 as if the agreement had not been made.

The courts have disagreed on the answer. But that disagreement depends upon the answers to three sub-questions:

(1) Did the parties intend that other agreed, limited remedies, such as the exclusion of consequential damages, were an integral part of the overall package of limitation? If so, the failure of the "cure" remedy means that other agreed limitations automatically drop out. If one remedy in an integrated package fails, the others fail with it.

(2) If the other limited remedies were not intended to be part of an integrated package, the question is whether the other remedies can stand on their own. Thus, if the other limited remedy was an independent exclusion of consequential damages, the question is whether that clause was unconscionable at the time of contracting.<sup>63</sup> § 2-719(3). In a commercial context, most courts have answered that question in the negative. In this setting, the buyer assumes the risk of consequential damages during the period that the seller tried and failed to "cure," and must be content with "direct" damages, if any.

(3) Even if the "other" limited remedies are independent of the failed package, other courts have asked whether the denial of consequential damages is "fair." The case for unfairness is best made where the seller failed to make a honest and reasonable effort to "cure," the loss to the buyer was substantial and no adequate remedies for direct damages were provided. In this setting, the court might conclude that the buyer has not been given a

---

62. See, e.g., *AES Technology Systems, Inc. v. Coherent Radiation*, 583 F.2d 933 (7th Cir. 1978); *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 95 A.D.2d 5, 465 N.Y.S.2d 606 (1983).

63. Section 2A-503(2) specifically provides: "If circumstances cause an exclusive or limited remedy to fail or its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article." (Emphasis added).

*“minimum adequate” remedy and provide the full panoply of Article 2 remedies. The focus here is not on the time of contracting, but on the effect of the failure and the seller’s conduct on the buyer’s legitimate interests.*

*(B) The Study Group recommends that efforts be made to clarify § 2-719(2), either in the text or comments. One possibility is to provide that after a “failure of essential purpose,” remedies as “provided by this Act” do not preempt other agreed remedies intended by the parties to be apart from the failed package and that are enforceable on independent grounds. At the maximum, a revision might clarify when the failure of an agreed remedy is so fundamental that the aggrieved party is entitled to a “minimum adequate” remedy regardless of an independent agreement.<sup>64</sup> At stake are the consequences of agreed risk allocation in commercial transactions. Obviously, the clearer the agreement that limits remedies or the more the buyer is involved in the cause of the failure of the goods, the greater the chance that the seller will prevail.*

### *3. Exclusion of Consequential Damages: § 2-719(3).*

*Apart from the relationship of an exclusion of consequential damages to § 2-719(2), only one revision in § 2-719(3) is recommended.*

*(C) The Study Group recommends the deletion the language of § 2-719(3) that declares a limitation of consequential damages prima facie unconscionable where there is injury to person “in the case of consumer goods.” Our recommendation is that plaintiffs injured in person from a breach of warranty should be held to the same standards as those who suffer only economic loss if they sue under Article 2.*

[TASK FORCE - 2-719]

## SECTION 2-719

The Task Force agrees with the observations and recommendations of the Study Group.

In response to the suggested revision posed in the Report at footnote 64, we recommend that the Drafting Committee consider in what situations, if any, a consequential damages exclusion should fail because of the occurrence of unanticipated circumstances when

---

64. See *Waters v. Massey-Ferguson, Inc.*, 775 F.2d 587 (4th Cir. 1985)(holding that parties did not intend to exclude consequential damages from a lost soy bean crop where seller, despite promises to cure, did not repair a tractor in time).

the seller is unable to honor a limited remedy of repair or replacement. We suggest that in some situations, unanticipated circumstances might give rise to an "intervening unconscionability" that would invalidate a provision excluding liability for consequential damages.<sup>469</sup>

*[PRELIMINARY REPORT - 2-720]*

*U. EFFECT OF "CANCELLATION" OR "RESCISSION" ON CLAIMS FOR ANTECEDENT BREACH: § 2-720.*

*No revisions are recommended in the text of § 2-720.*

*[TASK FORCE - 2-720]*

SECTION 2-720

The Task Force agrees with the Study Group that no revisions of section 2-720 are necessary.

*[PRELIMINARY REPORT - 2-721]*

*V. REMEDIES FOR FRAUD: § 2-721.*

*No revisions are recommended in the text of § 2-721.*

*[TASK FORCE - 2-721]*

SECTION 2-721

The Task Force agrees with the Study Group that no revisions of section 2-721 are necessary.

*[PRELIMINARY REPORT - 2-722]*

*W. WHO CAN SUE THIRD PARTIES FOR INJURY TO GOODS: § 2-722.*

*Rec. A2.7 (17).*

*No revisions are recommended in the text of § 2-722. The comment, however, should be revised to clarify that a buyer cannot*

---

<sup>469</sup> Anderson, *Contractual Limitations on Remedies*, 67 NEB. L. REV. 548, 581-94, 603-08 (1988) (exploring suggestion).

*accomplish indirectly through a conversion remedy what cannot be accomplished directly under § 2-716, i.e., specific performance.*<sup>65</sup>

[TASK FORCE - 2-722]

#### SECTION 2-722

The Task Force agrees with the Study Group's recommendation A2.7(17).

[PRELIMINARY REPORT - 2-723]

#### X. PROOF OF MARKET PRICE; TIME AND PLACE: § 2-723.

§§ 2-723(2) and (3), which deal with the nature and admissibility of evidence of alternative market prices, have produced no problems of substance.

*No revisions are recommended in the text of these subsections.*

§ 2-723(1) deals with an important problem in longer term contracts: How to measure damages under § 2-708(1) and § 2-713(1) when one party repudiates and the case "comes to trial before the time for performance with respect to some or all of the goods." The current solution is to use the "price of such goods prevailing at the time when the aggrieved party learned of the repudiation." This eliminates the uncertainty in attempting to prove what the price would have been at some future time and place of tender. There are, however, some omissions that have caused problems.

*Rec. A2.7 (18).*

The Study Group recommends two revisions in the text of § 2-723(1).

(A) *The time for measurement should be when the aggrieved party elects or should have elected to treat the repudiation as final, rather than at the time he learned of the repudiation. This recognizes the fact that the aggrieved party can wait for a "commercially reasonable" time after he learns of the repudiation, § 2-610(a), and fixes the time at the point when, if the aggrieved party has not already canceled, the reasonable time period has expired.*

*Second, it should be clear that the market price of "such goods" must be a reasonable substitute for the contractual conditions under which "such goods" were sold. Thus, if the goods were promised*

---

65. See *Ross Cattle Co. v. Lewis*, 415 So.2d 1029 (Miss. 1982).

*under a long-term contract, the price should be that available for goods under a similar contract, not the price on the "spot" market. At least, the aggrieved party should have the opportunity to prove the long-price with reasonable certainty before prices for shorter terms are admitted.*<sup>66</sup>

[TASK FORCE - 2-723]

#### SECTION 2-723

The Task Force generally agrees with the observations and recommendations of the Study Group regarding section 2-723. Consistent with our recommendations regarding the time for measuring damages under sections 2-708(1) and 2-723, however, we recommend that section 2-723(1) be revised so as to apply only when damages under sections 2-708(1) and 2-713 are to be measured at the time of the seller's tender of delivery. There would be no need for the application of section 2-723(1) when damages are to be measured at the time the aggrieved party should have elected to treat the repudiation as final.

[PRELIMINARY REPORT - NONE]

[TASK FORCE - 2-724]

#### SECTION 2-724

We assume that the Study Group makes no recommendations regarding section 2-724.

[PRELIMINARY REPORT - 2-725]

#### Y. STATUTE OF LIMITATIONS IN CONTRACTS FOR SALE: § 2-725.

*The Study Group did not reach any conclusions about § 2-725. At least one member would leave "well enough alone." Another member feels*

---

66. A case supporting this recommendation is *Manchester Pipeline Corp. v. Peoples Natural Gas Co.*, 862 F.2d 1439, 1446-48 (10th Cir. 1988). In long-term contracts between producers and pipelines for the supply of natural gas, the contract price will probably be lower than the "spot" market in a rising market and higher than the "spot" market in a falling market. The long-term price mechanism both evens out the risk of fluctuations over time and signals that the commitment to sell gas is backed by reserves.



*strongly that § 2-725 should be limited to claims for loss of bargain and that injustice results when § 2-725 is invoked in a products liability case. Still another member argues that since uniform laws generally do not have a statute of limitations, § 2-725 may be inappropriate for Article 2.*

*Given the fact that these and other questions about § 2-725 will be before the Drafting Committee, we have listed below some of the issues fairly raised by the presence of § 2-725 and some possible solutions. None of these solutions, however, has been endorsed by the Study Group.*

*(1) The scope of § 2-725 is frequently litigated. It applies to an action "for breach of any contract for sale." The "mixed" transaction gives the courts problems here as elsewhere. Also, some courts have concluded that if a breach of warranty causes personal injuries, the "tort" limitation rather than § 2-725 applies. Other scope issues have also been raised.*

*Do these scope disputes justify a revision for clarity? Arguably not, but this depends upon some agreement on the scope of "contract for sale" and the understanding that if you sue for breach of warranty you are burdened with § 2-725 regardless of the type of injury suffered.*

*(2) The versions of § 2-725 vary from state to state. This non-uniformity is accentuated by problems of mesh with other statutes of limitations in the state. The result is more choice of law problems for the courts. A careful study of these problems in variation and mesh would be useful.*

*(3) The limitation (repose?) period may be too short, especially in breach of warranty cases. The action must be commenced "within four years after the cause of action has accrued." § 2-725(1). The cause of action accrues "when the breach occurs," regardless of whether the aggrieved party had knowledge. A breach of warranty "occurs when the tender of delivery [presumably a non-conforming tender] is made" unless the warranty "explicitly extends to future performance of the goods." § 2-725(2).*

*In most cases, an aggrieved party will know or have reason to know of a breach within a short time after it occurs. In warranty disputes, however, the aggrieved party may not have knowledge of the non-conforming tender until after the four year period has passed. To aggregate the problem, the parties have no power to extend the limitations by agreement, although it can be shortened to "not less than one year." These constraints have contributed to the increasing pressure on the courts to expand the scope of tort, with its "discovery" statute of limitations.*

*A simple solution is to implement the difference between a statute of limitations and a statute of repose. In the former, the statute begins to run for a stated period when the aggrieved party knows or has reason to know of the breach. In the latter, the statute of limitations runs after the expiration of a longer, stated period without regard to when the aggrieved party knew of the breach. Thus, the limitation might be two years after the aggrieved*

*party knew of the breach and the repose might be 8 years after the cause of action accrued.*

*This simple solution would take considerable pressure off § 2-725, without seriously affecting interests of the breaching party. Compare § 2A-506(2).*

*(4) Other problems that require clarification include exactly when "a warranty explicitly extends to future performance," § 2-725(2), and when the statute of limitations is tolled because of representations or the like by the breaching party.<sup>67</sup>*

#### [TASK FORCE - 2-725]

#### SECTION 2-725

The Task Force has concluded that section 2-725 should be revised for greater clarity and simplicity. Even a cursory survey of existing case law reveals that the section has been rendered non-uniform in more than one respect. [cite ?] In assessing the cases, the bulk of inconsistent decisions involve confusion over one of two policy related issues: (1) the applicability of section 2-725 to personal injury claims, and (2) determining when a warranty "explicitly extends to future performance."<sup>470</sup>

The root cause of the different results in the cases is the perceived injustice caused by the drafters' decision to choose tender of delivery as the time when a breach of warranty occurs and a cause of action accrues (a date-of-delivery rule). Thus, it is possible that a breach of warranty action will be barred before the breach is actually discovered. One way to extend the limitations period is to find that the tort statute, not section 2-725, is the controlling statute. Under the typical statute, the accrual date is when the breach is or should have been discovered (a date-of-discovery rule). Another way to achieve the same result is to hold that the claim arises out of a warranty that "explicitly extends to future performance."<sup>471</sup> Because not all courts feel the same compulsion to apply a date-of-discovery rule, the cases are impossible to reconcile.

Section 2-725 should be revised in such a way that the statutory language becomes clear, and courts and legislatures no longer have

---

67. See Comment, *UCC § 2-725—A Statute Uncertain in Application and Effect*, 46 *Ohio St. L.J.* 755 (1985).

470 *U.C.C.* § 2-725 (1990).

471 *Id.*

the incentive to circumvent its application. To this end, the Task Force recommends adoption of a two-year statute of limitations that begins to run in all cases when the aggrieved party knows or has reason to know of the breach. The statute should specify that it shall govern even if a case properly under the Code is plead in tort. This should, as the Study Group suggests, decrease the pressure on courts to expand the scope of tort, with its "discovery" statute of limitations.

Most members of the Task Force disagree, however, with the suggestion that the section should include a provision similar to a statute of repose. There should be no outside limit on the right to bring an action. To include such a provision would necessitate the continuation of a hopelessly ambiguous future performance warranty exception. Otherwise, the value of an express or implied warranty may be threatened when the repose period is shorter than the duration of the express warranty, or the expected useful life of the good.<sup>472</sup>

Furthermore, evidentiary considerations do not justify a period of repose. One rationale underlying such a period, that the seller should not have to maintain its documents indefinitely, has limited persuasive value. If the alleged breach is unrelated to warranty, the probability that it will be discovered shortly after delivery is great. Therefore, the repose interest of the seller is adequately protected by a two-year statute of limitations. If the breach is warranty related, and is discovered several years after delivery, most of the relevant evidence will come not from the seller's records, but rather from the good itself and from experts who will testify as to how the good should have performed.

A second rationale, that sound financial decisions cannot be made without knowing when potential liability will end, is equally unpersuasive. At all times, the limitations period will be tied to the duration of the express warranty and, if not disclaimed, the implied warranty of merchantability. Thus, the period of substantive liability, which is presumably known by the seller, will set the outside limit for suits.<sup>473</sup> If it is finally decided by the Drafting

---

<sup>472</sup> Suppose the product has a normal life of twenty years and the repose period is ten years. If a latent defect appears during the fourteenth year, this may constitute a breach of the implied warranty of merchantability, but absent a statutory exception to the repose period the claim would be barred.

<sup>473</sup> More exactly, the outside limit will be the period of substantive liability plus two years.

Committee that a repose period should be incorporated into the statute, it should not begin to run until the first purchase for use or consumption.<sup>474</sup> This modification should go a long way towards alleviating some of the difficulties faced by consumers in their actions against manufacturers,<sup>475</sup> and by retailers in their indemnification actions against manufacturers.<sup>476</sup>

The Task Force favors the retention of subsections (3) and (4) without change. It is anticipated that, with the adoption of a discovery rule, the need to resort to extra-Code tolling law will greatly diminish.

---

474 See R.I. GEN. LAWS § 6A-2-725(5) (1985) (a ten-year statute of repose, dating from first purchase for use or consumption).

475 For a collection of some of the conflicting cases, see *Heller v. United States Suzuki Motor Corp.*, 64 N.Y.2d 407, 477 N.E.2d 434, 40 U.C.C. Rep. Serv. (Callaghan) 156 (1983) (holding that the limitations period begins to run in favor of a seller when delivery is made to its immediate buyer), *rev'd*, 101 A.D.2d 807, 475 N.Y.S.2d 146 (1984), *aff'd*, 64 N.Y.2d 407, 488 N.Y.S.2d 132, 477 N.E.2d 434, 40 U.C.C. Rep. Serv. (Callaghan) 917 (1985).

476 Compare *Richardson v. Clayton & Lambert Mfg. Co.*, 634 F. Supp. 1480, 1 U.C.C. Rep. Serv. 2d (Callaghan) 775 (N.D. Miss. 1986) (a claim for indemnity based on breach of warranty is governed by § 2-725) with *In re Fela Asbestos Litig.*, 638 F. Supp. 107, 1 U.C.C. Rep. Serv. (Callaghan) 389 (W.D. Va. 1986), *rev'd sub nom. Wingo v. Celotex Corp.*, 834 F.2d 375, 5 U.C.C. Rep. Serv. 2d (Callaghan) 309 (4th Cir. 1987) (implied contract of indemnity is outside the U.C.C. and not governed by § 2-725).

## APPENDICES TO TASK FORCE REPORT\*

## APPENDIX A\*\*

GENERAL COMMENT ON PARTS II AND IV:  
FORMATION AND CONSTRUCTION

Underlying every sales contract are the basic principles of good faith, the elimination of surprise and technical traps, and the interpretation of all phases of the formation and performance of the contract in the light of reasonable behaviour under the existing circumstances. When the parties to a sales contract are commercial men, the reasonable meaning of either language or actions is the commercial meaning in the commercial circumstances, and commercial good faith calls for observance of commercial standards by men of commerce. As the bulk of modern decisions apply to commercial agreements illustrative cases tend to focus upon these, but the same principles apply with equal force to non-commercial sales and contracts for sale. This Act rests firmly on the recognition of these principles and its specific provisions are drawn to further the application of these standards to sales agreements.

These principles have been developed in the holdings, case by case and point by point, but have not been explicitly phrased or consistently applied. This general comment on the formation and construction of the contract is supplied therefore to illuminate the case law recognition of these basic principles which are the underlying lines of guidance running throughout the whole body of better cases. This Comment is of necessity technical in nature rather than merely "introductory" to Parts II and IV of this Act. The best "introduction" to the meaning of these parts lies in the reading of the text of the Act itself. When specific problems of

---

\* The documents reprinted here appear as in the original and incorporate handwritten changes shown on the original. Any emphasis, blanks, footnotes, and errors are as in the original. The numbers in brackets inserted in the text indicate the original pagination.

\*\* Llewellyn Papers, file J(IX)(2)(a).

application arise, however, requiring the reading of one or more sections in the light of the whole plan of this Act, that plan must be made available with sufficient elaboration and detail of background, reason, and purpose to fill the particular need of court or counsel. That is the function of this Comment. More specific details are discussed in the Comments to the individual sections. Those comments both depend upon and supplement this General Comment.

1. *Good faith, commercial standards, avoidance of surprise are pervading principles of this Act.* The principles of good faith, protection of commercially reasonable conduct, reading of language and conduct against the background of the commercial sense of the contract, avoidance of surprise and technical traps run throughout this Act applying both to the formation and the construction of the contract. They are made express in specific instance after specific instance in which a conflict, confusion or lag in the case law has indicated that such explicit reference is necessary but whether or not they are expressed specifically in any particular passage they [p. 2] pervade each section and group of sections.<sup>[1]</sup> To these principles, particularly, the full language of Section 1 directly application of the whole Act in terms of its underlying principles and purposes, must be applied.

---

[1] See Section 17 and comment, which rejects any legalistic test of definiteness whenever the intention to close the agreement is clear; Section 29, Section 30, Section 33, recognizing "open" terms as to price, quantity and time; Section 29, Section 82, Section 86, Section 122, on failure of agreed terms as to price, inspection, delivery or payment and remedy; Section 18, Section 24, Section 123, dispensing with the requirement of consideration in the case of firm offers, modifications and renunciations made in good faith and not subject to attack for mistake or over-reaching; Section 30 imposing an obligation of due diligence to assure validity of an exclusive dealing agreement; Section 33 requiring reasonable notice for termination at will, Section 83 on right to a signed receipt, Section 77, and Section 80, providing for the avoidance of bad faith by surprise at the time of tender of delivery or payment; Section 21 and Section 126, requiring avoidance of surprise in offering proof of a usage of trade or a market price.

The application of these principles in matters not directly involved in the contract between the parties thereto but as involving third parties may be seen in the enlargement of the powers to transfer goods to good faith purchasers whenever the circumstances are such as to mislead him [Section 70 postamble abolishing "cash sale" reservation; Section 57 broadening the older rules on merchant's possession; Comment on Section 76 pointing out that reservation by delivery on condition is limited]. The purchaser is not protected however, unless he takes in current course of trade [Section 57 and Section 59] and the good faith of a merchant purchaser calls for reasonable observance of commercial standards [Section 10].

Nowhere is this more obvious than in the matter of reading the language of the agreement and conduct of the parties together to determine the respective rights and obligations of the parties. In their application and use, indeed, various of the particular provisions of this Act of necessity flow together. Thus, it is frequently impossible to say whether a course of conduct under a written agreement interprets the parties' original meaning or represents a subsequent standing waiver of some term or terms of the agreement. "Sometimes distinction between a waiver of default, or an extension of the time for performance, and acts which enlarge definition of a 'reasonable time' as contemplated by the parties beyond limits which might otherwise be set, is tenuous." *A. B. Murray Co. Inc. v. Lidgerwood Mfg. Co.* (1926) 241 NY 455; 150 NE 514, *Lehman, J.* The same holds true in regard to terms which, though explicit in form, are [p. 3] shown by the parties' conduct not to have been meant as written. "The contract appears to be wholly embodied in the writing. Notwithstanding this both parties seem to have treated the contract as partly oral and partly in writing . . ." *Niblett Ltd. v. Confectioners' Materials Co.* (CA) (1921 CA) 3KB 387 (written contract for 3000 cases of "condensed milk;" oral agreement that milk should be one of three named brands). Similarly, it is often impossible to determine whether a term added without words represents a tacit agreement resting in the circumstances or a rule derived from those same circumstances and imposed by law. [Compare Section 39 on the implied warranty of fitness for a particular purpose.] But without reaching a conclusion as to these questions, the obligations of the parties are made clear when good faith, the level of commercial understanding of the parties and avoidance of surprise are applied to the particular circumstances of the case.

2. *Explicit dickered terms are the foundation of the contract; Usage of trade read into explicit terms.* This Act accepts as of course the general law under which the parties control the terms of the contract (always subject to qualifications based on public policy). Without such terms duly agreed upon, there can be no contract within this Act. "Agreement" of course includes the terms of "the bargain in fact as found" not only "in the language of the parties" but also "in course of dealing, usage of trade or course of performance" as well as those terms or meaning of language which rest in 'implication from other circumstances;' (Section 9 defining agreement). These matters, together with the bearing of waiver, trade understanding and the like are further developed in the following. But

the case in which the agreement is not built upon language is a rare one. The explicit terms which the parties have joined in dickering out are the foundation and frame of the contract under this Act. Running throughout the following discussion of the interpretation of language in the light of the commercial background, of modification of the agreed terms by later action and the like, is the fundamental fact that it is the parties' own explicit, dickered terms, chosen for their own reasons which make and shape the deal.

First, then, words are used which must be read as they are understood in the trade. Whatever their meaning in the trade is the meaning which the agreement incorporates either between merchants or as against a merchant. This the better cases have long recognized. The warranty of merchantability, Section 38 for instance, rests on this assumption, as does the recognition of an unwritten usage of trade and course of dealing under the parol evidence rule, Section 15. This does not contemplate merely the introduction of usage to resolve an "ambiguity" patent even to an outsider, such as whether "ton" means 2000 or 2240 pounds. It may be that a quantity term refers to a measure accepted in the trade but which would not even suggest itself to a layman. (See *Fairmount Glass Works v. Cruden-Martin Wooden Ware Co.* (1899) 106 Ky. 659; 51 SW 196, where it developed that a "car-load" of Mason jars equalled 100 gross of pints, quarters of half gallons.) A usage may incorporate a meaning seemingly contradictory to the language used as in *Dixon, Irmaos & Cia. v. Chase National Bank* (1944, CCA 2d) 144 F. 2d. 759, where the rule of Section 47 of this Act, requiring payment against an adequate indemnity and a single part of a stipulated "full set of bills of lading" was recognized as current usage and incorporated by implication in [p. 4] the agreement to explain "the meaning of the technical phrase 'full set of bills of lading'."

A local usage may also be incorporated in regard to a contemplated local performance when it is reasonable that the local circumstances even though it is at variance with the expectation of a centrally located firm which ought to have informed itself as to local practice. So, under Section 21, on usage of trade, this Act rejects on this point the otherwise valuable case of *Finlay & Co. v. N.J. Kwik Hoo Tong* (1928) 2 KB 604, which involved a local usage in Java of treating shipment under CIF contracts as made within the month when steamer arrived if goods were then ready on lighters and were promptly loaded. Under this Act, unlike that



holding, a bill of lading dated "September" would not be held false where loading began October 1 and the vessel sailed October 3. Rather, this Act adopts by contrast the ruling of *Ronaasen & Co. v. Arcos, Ltd.* (1932 CA) 43 Ll. L. Rep. 1, which recognized a usage in the Russian timber trade that a "summer shipment" was satisfied by October shipment.<sup>[2]</sup>

3. *Strict construction in overseas documentary shipment contracts.* The mercantile evidence of the mercantile meaning of terms as employed in the better cases is responsible for the generalized statements as to strict construction of overseas shipment contracts. In those cases it has long been the custom and practice of merchants to demand strict compliance with certain of the contract terms particularly as to time and place. Thus, in *Bowes v. Shand* (1877, HL) 2 App. Cas. 455, the leading case on the strict construction of the time term for shipment (and, by dictum, also of the place term), the contract called for rice "to be shipped at Madras or Coast", "March and/or April," and 296 out of 300 tons were put aboard the ship in February. Evidence was introduced that in the trade such time stipulations were intended to be literally performed. Because of the earlier loading the entire shipment was held to be rejectable.

In the case of all documentary contracts trade usage has now crystallized beyond challenge the requirement that all necessary documents be both in correct form and unimpeachable for falsity whether they are presented under a letter of credit as in *Laudisi v. American Ex. Ntl. Bank* (1924) 239 N.Y. 234; 146 NE 347, or directly to the buyer as in *Finlay & Co. v. Kwik Hoo Tong* (1928) 2 KB 604, discussed above. The requirement as to correct form has been incorporated in this Act in Section 72 on manner of tender of delivery, and Section 44 on CIF and CAF terms, and the effects of falsity of documents are set forth in Section 67 on excuse of financing agency. However, even strict construction is controlled by the commercial [p. 5] meaning of language, as for example, under Section 47 in the case of a stipulation as to a "full

---

[2] See also *Guillon v. Earnshaw* (1895) 169 Pa. 463; 32 At. 545, permitting evidence of trade custom of Spain as to acceptable quality of ore where vendors were to perform their part of the agreement in Spain; *Star Glass Co. v. Morly* (1871) 108 Mass. 570, where sizes of glass to be manufactured in Philadelphia were held to be determined by Philadelphia standards; *Moore v. United States* (1905) 196 US 157, holding that the customary mode of discharge at Honolulu controls in contract for delivery of coal there.

set" of bills of lading, or where a designation not properly within a third party's knowledge is allowed to be shown by invoice. (Laudisi v. American Ex. Natl. Bk. (1924) 239 NY 234; 156 NE 347, where a rail bill of lading covered grapes "condition and contents unknown" and the invoice supplied the needed term "Alicante Bouchez"; O'Meara Co. v. National Park Bank (1925) 239 NY 396; 146 NE 636, where the details of the merchandise were held to be adequately evidenced by the invoice.)

4. *Destination and domestic contracts: Time term.* In destination contracts, as opposed to shipment contracts discussed above, where the time of shipment serves chiefly as a rough indication of the prospective time of arrival and has no bearing upon the buyer's risk, a broader construction of the time term is indicated by trade usage which has readily been admitted for this purpose. So, in National Importing Co. v. E.A. Bear & Co. (1927) 324 Ill. 346; 155 NE 343, under a contract calling for shipment "from the Orient, 75 cases in April", the goods were put aboard on March 31. The buyer was not permitted to reject the shipment partly because of a trade usage sustaining the variation and partly because a term permitting such a wide range of shipping points left no reason for the application of a strict rule. So also have the circumstances of the case been recognized as affecting the meaning of a term in a destination contract. Thus, in Lamborn v. National Bank of Commerce (1928) 276 US 469; 48 Sup. Ct. 378, where the contract called for shipment by steamer "from java" to Philadelphia, a shipment by a steamer which was diverted to Philadelphia from its original destination was held good.

A fortiori, in domestic contracts, a time term must be given, the meaning which comes to it in the trade although it is seemingly precise or fixed by case-law in its general effect. This Act, therefore, approves the holding of such cases as Colonial Iron Co. v. Workman (1923) 81 Pa. Super. 51, which treated a clause requiring deliveries "during the last half of year" as subject to interpretation by a usage requiring periodical deliveries; and rejects such cases as Clifton Shirting Co. Inc. v. Bronne Shirt Co. Inc. (1925) 213 App. Div. 239; 209 NYS 709, which refused to admit evidence of a usage that "delivery June, July, August" called for deliveries in each month.<sup>[3]</sup>

---

[3] For other cases involving flexible construction of the time term in

[p. 6] The circumstances of the case, as well as trade usage, can affect the meaning of the time term as in *Beck & Pauli Lithographic Co. v. Colorado Milling & Elevator Co.* (1892, CCA 8) 52 Fed. 700, in which an eight day delivery in delivery of specially manufactured advertising stationery was held justified by the circumstances of the case, and in *Second National Bank of Alleghany v. Cash* (1924, CCA 3) 299 Fed. 371, in which it was held that a contract calling for goods to be "shipped immediately" meant that they were to be shipped as soon as possible under the circumstances known to both parties.

Thus, when courts remark in regard to the alleged rule that "time is of the essence of a mercantile contract" that "the tendency of modern law is to relax the strictness of this rule" (*Kieckhefer Box Co. v. John Strange Paper Co.* (1923) 180 Wis. 367; 193 NW 487, they are actually noting the current recognition of usage and the circumstances of the case as interpretive of the time term except in those contracts which are truly "mercantile" in the original sense, the overseas documentary shipment contracts. In those cases the trade practice of strict compliance has allowed no broadening of the terms, but even so cancellation of the whole contract for deficiencies in an installment is subject to the rule of reason indicated in Section 101 permitting cancellation only where the breach substantially impairs the value of the entire contract.

5. *The quantity term is also subject to usage of trade.* Both the English Sale of Goods Act, Section 30(4) and the Original Sales Act, Section 44(4) sought by explicit provision to forestall that type of literal interpretation of sales contracts which would bar proof of a trade usage as to quantity terms. These Acts proceeded on the assumption that dickered terms are likely to be shorthand trade expressions which in the case of quantity might require acceptance of a reasonable quantity, more or less, or allow replacement of a nonconforming portion or require the buyer to take reasonable (as

---

domestic contracts, see *Cobb Lumber Co. v. Sunny South Grain Co.* (1926) 36 Ga. App. 140; 135 SE 759, holding good a shipment of feed stuff made three days after contract date; *Ronaasen & Co. v. Arcos, Ltd.* (1932 CA) 43 Ll. L. Rep. 1, allowing satisfaction of a contract for "summer shipment" by October shipment under usage in Russian Timber Trade; *Bossemeyer Bros. v. Woodson County Grain Co.* (1921) 108 Kan. 534; 196 P. 431, recognizing the rules of a grain dealer's association under which both parties acted as establishing a usage that "immediate shipment meant in three days, "quick" shipment five days, and "prompt" shipment ten days.

contrasted with burdensome) action to sever the contract goods from a larger amount. Thus, the conditions of bulk shipment are such that the contract may envisage a 5, 10 or 15% variation by trade usage without the use of an explicit term to that effect or even the inclusion of the words "about" or "approximately". (See *Beals v. Hirsch* (1925) 214 App. Div. 86; 211 NYS 293, involving evidence of a trade usage requiring acceptance of pieces 6 to 7 yards short under contracts calling for 60 yard pieces.)

The courts, unfortunately, have tended to be singularly strict in regard to any usage offered to explain quantity terms and have practically disregarded the explicit rules of both the English and our Original Act treating the figures in quantity terms almost as if they had magic value. "The commercial man says: 'I have undertaken to deliver a particular size, but it is reasonable that I should be allowed to deliver a certain percentage which is not that size.' If he says that he must put it in the contract." (Scrutton, L.J., in [p. 7] *Ronaasen & Co. v. Arcos, Ltd.* (1932 CA) 43 Ll. L. Rep. 1.<sup>[4]</sup>)

This Act intends to reject and change this uncommercial current of cases and to reestablish on this point the purpose of the Original Act, Section 44 (4). No particular mention of the quantity term is made in the text of Section 21 on usage of trade because the matter set forth in that section is addressed equally to all contract terms of any character. Instead this Act makes clear its intention to restore the quantity term to the same treatment as other terms by omitting the special and detailed provisions as to discrepancies in quantity found in the Original Act, Section 44, so as to remove that over-emphasis on the quantity term which has misled courts into viewing with disfavor the introduction of usages to explain the meaning of such terms.

---

[4] Compare *Harland & Wolff, Ltd. v. J. Burstall & Co.* (1901 KBD) 84 L.T.N.S. 324, holding that a reasonable usage permitting a 10 per cent variation was not established and that tender was inadequate where contract called for 500 loads of timber and 470 were shipped; *Mutual Chemical Co. v. Marden, Orth & Hasting Co.* (1923) 235 NY 145; 139 NE 221, which painfully recognized a usage which made a tender of 36,418 lbs. of potash acceptable under a contract calling for 36,000 and actually placed the holding on a "de minimis" basis; *Burros & Kenyon Inc. v. Warren* (1925 CCA) 9 F (2d) 1, holding lumber trade usage permitting 10 percent variation in an order and the filling of smaller sizes by shipping half the quantity in their doubles "not established" and of dubious admissibility to "vary" the written terms.

Where usage incorporates limits of tolerance into a quantity term (whether a flat term or stated as "about" or "approximately") a commercial pattern of acceptability within these recognized tolerances but with price adjustment for the variation from the stated standard where the price is fixed per unit, has been established. This pattern is a general one and covers quality or other discrepancies as well as quantity. Thus, in *Peabody & Co. v. Ralli Bros.* (1921 KB) 9 Ll. L. Rep. 201, a solid trade usage existed making delivery acceptable with allowance up to a ten percent variation where sugar was impaired by discoloration. The arbitrators awarded accordingly since only 125 out of 2000 bags were not up to the stated standard in that case. The usage was entirely reasonable and this Act rejects the absurd holding of the court which vacated the award because the "custom" was supposed to be "directly against the law."

6. *Contracting out of trade usage, course of dealing or the interpretation indicated by the circumstances of the case: Avoidance of surprise.* The preceding paragraphs have emphasized the role of trade usages in the construction of sales agreements but the background of meaning to be read into terms or into gaps in terms shows as clearly in a fixed course of dealing between the parties and the circumstances of the case as in usage of trade. (See Section 9 defining "agreement," Section 21 on course of dealing and usage of trade, and Section 15 on the parol evidence rule; See also *Paddleford v. Lane & Co. Inc.* (1916) 223 Mass. 113; 111 NE 769, where an alleged contractual right to inspect cabbages before payment against bill of lading was based on fact that "in all previous dealings" between parties such inspection was permitted.)

[p. 8] The background of circumstances against which the agreement is entered into and performed may supply terms not explicitly agreed upon as in those instances in which "reasonableness" is read into time and method of inspection terms (Section 82) or as to facilities to be provided for receiving delivery (Section 72). What is "reasonable" will be determined by the particular circumstances. Or, circumstances can add to the explicitly agreed terms as in the case where a warranty of fitness for a particular purpose is added to that of description because of the circumstances of the transaction and particularly the buyer's reliance on the seller's skill and judgment. [See Section 39 on warranty of fitness, Section 40 on exclusion of warranties, and Section 41 on cumulation of warranties.] Finally, the circumstances may qualify the meaning of an explicit term as in *Syzmonowski & Co. v. Beck & Co.* (1923 CA) 1 KB

457, where goods intended for export shipment were stored in a warehouse during a trade depression and it was held that a fourteen day clause limiting time for notice of defects did not prevent the buyer from claiming damages when shortages of yardage was discovered after ultimate shipment to buyer's customer.<sup>[5]</sup> It is plain that in the matters of reading agreements in the light of trade usage, course of dealing or the circumstances of the case, the problems of *formation* (i.e., of incorporating material into the agreement) and of *construction* (i.e., determining the meaning of the agreement) overlap and even coincide. These problems are here discussed in this manner, therefore, even though the relevant sections of this Act have been arranged in the more familiar traditional fashion under the two separate headings.

When the express language used in the agreement conflicts with the applicable trade usage, course of dealing or circumstantial background, a vital question is raised by Section 21 on course of dealing and usage of trade which provides that the express terms shall control usage and course of dealing in such a case. By implication the express language would also, of course, control any inference from the circumstances. That section, however, makes clear that the express terms shall dominate only when such construction is reasonable. The office of the language of that section and of Section 15 on the parol evidence rule is to negate and reject that line of cases which has been misled into a literalistic reading of commercial language. Under the same principle a liberal approach to any problem of *latent ambiguity* revealed by the circumstances is also called for. This is the "supplementary principle" saved without specific mention under [p. 9] Section 2 whenever it is unreasonable to construe all the sources of meaning consistently.

No inconsistency of language and background exists merely because the words used mean something different to an outsider

---

[5] For an example of circumstances qualifying a time term, see *Coyne v. Avery* (1901) 189 Ill. 378; 59 NE 788, involving five cases of eggs deliverable in Chicago to be shipped on named days from points in Kansas or Nebraska where no rejection was permitted for one day's delay in shipment because the wide range of shipping points made it immaterial. Circumstances qualified a term of description in *Schmoll Fils & Co. v. L.S. Agoos Tanning Co.* (1926) 256 Mass. 195; 152 NE 630, where a delivery of "12/20" hides was held effective under a contract calling for "13/20" hides as being recognized as equally good in the leather trade so that shipment of "12/20" hides were interchangeably made on contracts calling for "13/20" hides.

than they do to the merchants who used that language in the light of the commercial background against which they contracted. This is the necessary result of applying commercial standards and principles of good faith to the agreement under Section 26. Moreover, where the commercial background normally gives to a term in question some breadth of meaning so that it describes a range of acceptable tolerances rather than a sharp-edged single line of action, any attempted narrowing of this meaning by one party is so unusual as not likely to be expected or perceived by the other. Therefore, *attention must be called to a desire to contract at material variance from the accepted commercial pattern* of contract or use of language. Thus, this Act rejects any "surprise" variation from the fair and normal meaning of the agreement. (See, for example, Section 19) requiring "unambiguous indication" of any peculiar variation from the normal meaning of an offer; Section 40 on exclusion or modification of the normal warranties; Section 20 on the additional proposed terms which may be read into an agreement by failure to object.)

7. *The principle of reasonable construction and against surprise.* There lies in this "attention-calling" requirement a key to much which is puzzling in the sound cases when explicit terms are under construction. "Explicit" terms are of two types which have strikingly diverse significance. On the one hand are those terms which are consciously dickered out by the parties and which are usually represented by their telegrams, interchange of correspondence or by the typed or handwritten fill-ins on a form. On the other hand are those clauses contained in a form or inserted by one party in a lengthy contract which the parties never consciously bargain out and to which the attention of the other party is never directed.

The "dickered" terms of the agreement are, of course, always to be read against the commercial background but they must also be read as terms to which both parties' attention was in fact addressed. How exclusively the parties tend to concentrate on such terms, often ignoring entirely the form clauses, is shown sharply in those cases in which the courts have been forced to disregard inapposite or repugnant form clauses which would have been stricken out or modified had the parties given the form any attention. [See *Great Eastern Oil Co. v. DeMert & Dougherty* (1943) 350 Mo. 535; 166 SW 2d 490, where an order was given in 1931 on a form providing for monthly deliveries during 1930; *Alison v. Wallsend Slipway & Engineering Co.* (1927 CA) 27 Ll. L. Rep. 285, where a letter contract for the purchase of one cylinder referred to "our usual strike and guarantee clauses" which were contained in a

form contract for a complete engine; *Finkelstein v. Morgenstern* (1924) 144 Md. 387; 124 Atl. 872, involving a contract containing an elaborate clause for termination of credit at any time "with respect to undelivered merchandise" which was held inoperative where the contract called for delivery "at once" since clause applied only to merchandise properly undelivered and not where the seller was [p. 10] in default on delivery.][<sup>6]</sup> Thus, the familiar rule that "writing controls printing" is actually a recognition of the fact that the parties' minds, in the process of dicker, are directed primarily to the terms under actual negotiation and not to the clauses on the form.

This practice of ignoring those clauses not actually bargained out may frequently work hardship through surprise on one party if the form terms which he does not specifically consider at the time of contracting prove unfair or unreasonable. Hence, another familiar rule which calls for "construction most strongly against the party preparing the document" has arisen and rests upon this strong likelihood that the party who merely "adheres" to a prepared contract has given its form portions no careful consideration. Yet this generalization of law is inaccurate and misleading, representing neither the rule as applied by the better cases nor the sound method for construing commercial agreements under this Act. For if the clause in question makes commercial sense and is commercially fair, the courts should not construe it "most strongly against the party who prepared it" but, rather, should interpret it in a manner fair and reasonable to both parties. There is nothing novel in this proposition. Thus, in *St. Regis Paper Co. v. The Santa Clara Lumber Co.* (1906) 186 NY 89; 78 NE 701, a reasonable agreement in regard to lumbering advances was reasonably and liberally construed so as to permit the buyer to require specific performance of the contract although he had failed to make the required advances because of his misinterpretation of the contract. See similarly, *Pottash v. Herman Reach & Co.* (1921 CCA 3) 272 Fed. 658,

---

[6] Contrast the parties' unusual attention to the forms in *American Sugar Refining Co. v. Page & Shaw, Inc.* (1927, CCA 1) 16 F (2d) 662, where the court gave full effect to a difficult but "not unusual" delivery clause obviously retained by parties for a purpose when many other clauses of the form were stricken out; and in *Lipschitz v. Napa Fruit Co.* (1915, CCA 2) 223 Fed. 698, where the parties used a "rail" form but wrote in: "All other conditions to be those embodied in regular water contract," which was a familiar and balanced standard form worked out between an organization of buyers and one of sellers.



which contains a vigorously favorable interpretation of sellers' clauses for forced acceptance despite delay and shortage where parties obviously contracted with reference to war conditions of overseas trade which made the clause reasonable in the circumstances; and *Dery v. Blate* (1924) 239 NY 203; 146 NE 204, in which credit revocation clauses were given their full needed effect, duly limited by commercial sense and understanding and the "most strongly against" rule was invoked not against the clause but against the seller's effort to extent artificially the meaning of the clause.

So, whether the language used be ambiguous or otherwise in need of interpretation, a blind application of *contra proferentem* construction which throws out or emasculates a reasonable clause runs counter to commercial sense and to this Act. *Reasonable clauses are to receive a reasonable construction whoever may have prepared them.* This Act adopts and approves the holdings of such cases as *McAndrews & Forbes Co. v. The Mechanical Mfg. Co.* (1927) 367 Ill. 288; 11 NE (2d) 382, where a clause printed at the foot of the seller's letterhead on [p. 11] which the agreement was typed made "all agreements contingent on causes beyond our control." The court held that such clauses usually refer to strikes and the like and were not intended to override a warranty that the machine sold would operate continuously for 24 hours although the seller claimed at trial that it was impossible to construct such a machine. (See also *American Almond Products Co. v. Consolidated Pecan Sales Co. Inc.* (1944 CCA 2) 144 F. (2d) 448, in which L. Hand, J. gave a commercial construction to a single party's statement of issues for a commercial arbitration.) As always, under this Act, the test of reasonableness in such cases is consonance with the general commercial background or with the perceptible commercial needs of the particular trade or case.

Reasonable clauses take no man by surprise and indeed are the clauses which are expected to be included in a form which one party has not read or studied. But when a clause or set of clauses is so unfair or so one-sided that it is not to be expected either between decent merchants or from a decent dealer, their contents enter by surprise. It is in such cases that the courts have insisted upon some type of special warning of the presence of such surprise clauses by refusing otherwise to give the clause its full scope and breadth, as in *H.C. Smith v. Oscar H. Will & Co.* (1924) 51 ND 357; 199 NW 861, where the court held that a general non-warranty clause appearing in the seller's catalog, invoices and letterheads did not preclude the buyer from recovering where clover seed was

mistakenly delivered instead of alfalfa seed. Similarly, in the *Ne-whall Land & Farming Co. v. Hogue-Kellogg Co.* (1922) 56 Cal. App. 90, the court held that the warranty of identity of the variety of lima bean seed ordered was not excluded by a disclaimer printed in small type on the vendor's letterhead. In contrast in *Hogue-Kellogg, Inc. v. G. L. Webster Canning Co.* (1927 CCA 4) 22 F (2d) 384, which involved a Virginia statute providing that "no printed form contract . . . shall be binding" unless the clauses for the vendor's benefit are in type of described minimum size, the court construed the statute so as to let in a full set of fair and reasonable clauses following the principle of this Act that reasonable clauses are entitled to be given their reasonable effect.

8. *Unconscionability.* Frequently the courts have adopted other lines of approach to this same problem of unfair surprise clauses. They have called upon the rule against trick, artifice or strategem, have eviscerated the unfair clause by adverse construction, have manipulated the rules of offer and acceptance to keep the clauses out, or have knocked it out as contrary to public policy or to [p. 12] the dominant sense of the contract.<sup>[7]</sup> Despite the inconsistent

---

[7] For examples of judicial policing of contracts for unconscionable clauses, see: *Kansas City Wholesale Grocery Co. v. Weber Packing Co.* (1937) 93 Utah 414; 73 P (2d) 1272, where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; *Hardy v. General Motors Acceptance Corp.* (1928) 38 Ga. App. 463; 144 SE 327, holding that a disclaimer of warranty clause applied only to express warranties thus letting in a fair implied warranty; *Andrews Bros. v. Singer & Co.* (1934 CA) 1 KB 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description even though the Sale of Goods Act called such an implied warranty; *New Prague Flouring Mill Co. v. G.A. Spears* (1922) 194 Ia. 417; 189 NW 815, holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction does not indefinitely postpone the date of measuring damages for the buyer's breach to the seller's advantage; and *Kansas Flour Mills Co. v. Kirks* (1917) 100 Kan. 376; 164 P 273, where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; *Green v. Arcos, Ltd.* (1931 CA) 47 TLR 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; *Meyer v. Packard Cleveland Motor Co.* (1922) 106 Oh. St. 328; 140 NE 118, in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as dump truck; *Austin Co. v. Tillman Co.* (1922) 104 Or. 541; 209 P. 131, where a

lines of rationale upon which these holdings have rested, they have a single and sound result and they are based upon a single principle: they deliberately disregard or misconstrue the language of *one* party in order to make effective the actual bargain made by *both* parties, eliminating as unconscionable those elements which rest on unfair surprise. But the cases have been uncertain in application of this principle and the diversity of the reasoning has kept them from [p. 13] providing consistent and accessible lines of guidance for the draftsman or the court which has led to much unnecessary litigation.

This Act brings the principles of formation and construction together into a simple and consistent working structure. All language is to be given its fair commercial meaning against the background of the trade and the situation and the temptation to misread the language for justice's sake (which runs through so much of the case law) is removed by Section 23 which provides for the striking out of unconscionable clauses or sets of clauses. Unconscionability may be found in the pure content of a clause or set of clauses as applied to a given situation. [For example, see Section 33 on arbitrary termination by one party, Section 11 on arbitrary time fixing, and Section 121 on arbitrary fixing or limitation of damages.] On the other hand, unconscionability can also be found, when the facts about making deals on forms are viewed realistically, in the combination of an unfair (although less extreme) clause or set of clauses with the element of surprise.

9. *Avoiding surprise, in practice, when terms are varied from the expected background.* It is clear that no problem of surprise is present when the background of the trade itself or the circumstances require

---

clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; *Beckevold v. Potts* (1927) 173 Minn. 87; 216 NW 790, refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; *Robert A. Munroe & Co. v. Meyer* (1932) 2 KB 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered; *Lumbrazo v. Woodruff* (1931) 256 NY 92; 175 NE 525, in which even "recognition" of a total non-warranty and non-remedy clause regarding seeds was limited to excluding consequential damages for loss of crop "provided of course that the defendants had resorted to no fraud, unfair dealing or negligence amounting to undue enrichment." [Compare Section 37 and 41 of the Act and Comments which show that once the real subject matter of the bargain has been determined, no printed clause can change it although the remedies for breach can be limited within reason (Section 40.)]

the particular term or interpretation of language. Thus, in the case of overseas documentary shipment contracts discussed in paragraph 3, above, strict compliance with time and place of shipment terms is dictated by the trade usage. Similarly, the circumstances of the transaction call for strict reading of the quality requirements of a contract for chemicals to manufacture gas masks, of a contract for precision parts, or of the time of delivery of a machine needed for a particular construction job or for harvesting machinery during the pending season. Thus, this Act approves such holdings as *Nelson v. Imperial Trading Co.* (1912) 69 Wash. 442; 125 P 777, where an order given in mid-November for two tons of turkeys was properly recognized by the court as directed to the Thanksgiving trade and a duty imposed upon the seller to ship in time to meet the needs of that commercial situation. And this Act rejects such a construction as made in *Kemper-Thomas Co. v. Deitz* (1918) 204 Mich. 84; 169 NW 826, where a Christmas order for frame purses calling for shipment on or about December 1 was filled by shipment on December 19 "in abundant time to reach Ann Arbor several days before Christmas," and the court directed a verdict for the seller for the price.

Where, however, the background of trade or circumstances does not make it entirely clear to both parties that performance above and beyond the usual commercial pattern will be necessary, attention must be called to this fact. The simple commercial means of calling attention to what is being demanded lies in the use of language which both raises the point and then settles it. In those frequent cases where form contracts are used the points must be raised in those specially dickered portions of the agreement which are filled in for the particular deal and thus always noted. Thus, notice of intended general strictness would be given by such terms as appeared in the *Commonwealth Title Ins. & Trust Co. v. Gregson* (1922) 303 Ill. 458; 135 NE 715, where the contract read: "Specification - Strictly new cure, strictly choice quality, new cooperage, heavily salted, proper saltage allowance, packed suitable for export, for arrival at New [p. 14] York not later than June 19."<sup>[8]</sup>

---

[8] The actual holding of the Gregson case in regard to the unforeseen supervening difficulty is not approved by this Act under Section 87 and Comment on substituted performance.

Similarly, the language may make unmistakable that the requirement of quality is more exact than ordinary trade usage would call for. So, in *Rosenbaum Hardware Co. v. Paxton Lumber Co.* (1919) 124 Va. 346; 97 SE 784, the following language gave adequate notice of the requirement of strict compliance where oak was being procured to fill a government contract. "Quality: To be selected white oak, straight grained and free from knots, heart centers, shake, wormholes, sap and other defects except as noted below . . . Defects allowed: Some pineworm will be allowed providing it does not damage the piece for the purpose for which it is intended." Or, in *Powers v. Dodgson* (1917) 194 Mich. 133; 160 NW 432, where after assurance by the seller that there was not more than 300 lbs. of fine wool in a certain lot, the buyer agreed to purchase the wool at a stipulated price "If there ain't over 300 pounds" of the fine wool in the lot; the presence of over 2000 lbs. of fine wool entitled the buyer to reject the goods.

The language of the dickered terms may likewise call attention to the fact that precise performance as to time of delivery is essential, as in *Deming Co. v. Bryan* (1911) 2 Ala. App. 317; 56 So. 754, where an order for a spraying machine directed the seller to "ship quick", as there would be damage to the crop by delay. Similarly, in *Green Duck Co. v. Patterson & Hoffman* (1912) 36 Okla. 392; 128 P 703, where a statute provided that time is not of the essence unless otherwise agreed and the contract called for 2000 watch fobs, "must reach [buyer] not later than February 25," the court held that goods shipped in March were rejectable. (See to same effect *Augusta Factory v. Mente & Company* (1909) 132 Ga. 503; 64 SE 553, where time became of essence of contract for sale of cloth to be resold as sugar bags to buyer's customer when buyer expressly stipulated dates of delivery.)

Normal credit practice may be similarly narrowed as in *Weyerhaeuser Timber Co. v. First National Bank of Portland* (1938) 150 Or. 172; 43 P (2d) 1078, where in the face of a custom that a "cash sale" meant a short credit period, the contract expressly provided for cash upon receipt of documents after the buyer had requested a 15 day credit period and been refused, the express language was properly held to override the trade usage.

10. *The flexible character of commercial contracts.* Some difficulty arises from the ambiguous character of the common practice among merchants who have or expect to have continuing relations of accepting "with an adjustment" usable but slightly deficient merchandise or materials for further manufacture. The question is

immediately raised as to whether such conduct represents a *favor*, through a [p. 15] unilateral waiver of a term, or a *right* implicit in the contract and being recognized in the course of performance. Good faith forbids that favors should be turned into unalterable rights and certainty demands that fair doubts should be resolved in favor of explicit terms. But the evil of literal or rigid reading of commercial language so as to require what is commercially impractical must be avoided as must the possibility that one party be permitted to take the other by surprise by a sudden and unexpected withdrawal of a "waiver" of an explicit term.

Actually most commercial obligations have a flexible character which our legal vocabulary has had some trouble in grasping but which has always been reflected in the spirit of the better commercial cases. They represent a going relationship not rigidly defined at the moment of contracting but changing in shape and structure in the process of performance or of getting ready to perform or to fit supervening circumstances. The available legal concepts tend to flow into one another: the use of the circumstances and the parties' actions to interpret the terms; the exercise of an option within an agreed range; waiver in any of its aspects and even modification of a term. (Compare paragraph 1 of this Comment.)

Thus, if in confirming a contract the buyer adds "Rush the January delivery," it is certain that he is only calling for such speed as is commercially practicable to the seller. It is not clear, however, whether the case is one involving an additional term proposed under Section 20, or a reflection of the general commercial understanding that the "seller's legal option to deliver at any time up to the last day" is subject to modification on buyer's initiative, or the beginning of a course of performance which followed by a request to "Hold February delivery till Mar. 15," duly acted on, will show that the stated time term contains leeways.

Similarly, the buyer's failure to raise any objection because of a delay or deficiency patent on the face of the delivery not only bars him from any remedy therefore under Section 96 on the effects of acceptance, but may also constitute part of a course of performance under Section 22 which can help to determine the meaning of the contract. Indeed, the policy of Section 96, although phrased in terms of notice of breach, rests substantially on the commercial fact that acceptance plus silence for an unreasonable time most likely spell acceptance not only in legal satisfaction but in actual satisfaction of the contract *as understood by the parties*. So

the buyer's actions upon delivery under an installment contract may show that the terms were meant to be strictly adhered to, or that complying units making up the bulk of a delivery are acceptable with replacement of the non-complying ones; or that a whole non-complying delivery is subject to replacement; or, in general, an understanding between the parties as to permissible leeways in time, quality or quantity within which any delivery is acceptable with or without appropriate allowances.

Even with regard to single deliveries the courts have dealt in the same way with the behaviour of the parties and Section 26 of this Act on good faith and commercial standards calls for continuation of such treatment. Thus, unstated variations from stated terms have been held "waived" by the buyer's statement of other objections at the time of rejection when his rejection has been in patent commercial bad faith and due not to the nature of the performance but to a [p. 16] drop in the market or other similar circumstances which has made the contract unprofitable to him. In result, the courts in such cases have thus soundly used the buyer's conduct as a clear indication that literal compliance with the terms as written had no more been understood by the buyer to be of the essence than it had been by the seller and in consequence have made difficult a surprise rejection in commercial bad faith. So in *Second National Bank of Allegheny v. Lash Corp.* (1924 CCA 3) 299 Fed. 371, involving a contract made on July 8 for "immediate shipment," the letter of credit was not secured by the buyer until July 20. The first car was loaded on July 23 and the second, due to a car shortage, on July 27. After a severe market drop the buyer attempted unsuccessfully to cancel the contract and then refused to accept the shipments "for undue delay." The court permitted the seller to recover holding that defects in the bill of lading later claimed by the buyer had been waived by failure to state them at the time of rejection and, moreover, read the term "immediate shipment" as "leaving some latitude with respect to performance" in view of the known circumstances. Under this Act, in fact, the buyer's delay in opening the credit would be enough as against him to show such latitude on time of delivery (See Section 49 plus Section 11).<sup>[9]</sup> However, where the buyer's can-

---

[9] See also *Fielding v. Robertson* (1925) 141 Va. 123; 126 SE 231, where buyer rejected cotton meal during a price decline assigning as his reason delay in delivery which failed as a justification; also, despite a "strict quantity"

cellation is in good faith and because a non-conforming delivery is not acceptable to him under his understanding of the contract terms, neither a drop in market price nor his failure to state a particular defect in his rejection should operate automatically as a waiver of the unstated defect. [See *Dexter Yarn Co. v. American Fabrics Co.* (1925) 102 Conn. 529; 129 Atl. 527, where the buyer's cancellation of a whole contract for yarn was held justified as a matter of law despite a severe drop in the market when he had given the seller an opportunity to cure a defective installment and the latter had failed to do so.] Indeed, Section 94 on statement of defects is carefully drawn to prevent such automatic waiver by mere failure to state defects in order to protect the normal informality of commercial communications. The same section, however, must and does protect a seller who is misled to his prejudice by the buyer's expressions or silence. It also affords the [p. 17] seller a means of procuring from the buyer a full and final statement of objections. But that section, like every similar section of this Act, presupposes good faith, and therefore leaves untouched the results of that line of cases discussed in footnote 9 in which the buyer has acted in commercial bad faith. It flatly rejects, however, those cases which have applied a blind rule of automatic "waiver," by non-statement such as *Ginn v. W.C. Clark Coal Co.* (1906) 143 Mich. 84; 106 NW 867, where the buyer having rejected coal because it was not of the type ordered was not permitted upon the trial to prove that it was not of merchantable quality.

In the same way and for the same reasons the rule of Section 90, which allows and encourages partial acceptance of a delivery in good faith is entirely consistent with those cases which have

---

rule in the jurisdiction the court disregarded a 10 percent shortage holding that the bill of lading showed a full shipment and requiring the buyer, if shortage developed en route, to complain and permit reasonable opportunity to cure; *Nathew v. George A. Moore & Co.* (1925 ND Calif.) 4 F (2d) 251, Affd. (1926 CCA 9) 13F. (2d) 747, where sugar was shipped on May 31 and July 27 under a "May-June" Saigon term during the 1920 scramble and price drop and was rejected by the buyer "account quality and single bags" which causes were held to be untenable and the delay then held to be no justification since "it had nothing whatever to do with the rejection"; *Toledo Furnace Co. v. Lansing Co.* (1922) 220 Mich. 207; 189 NW 864, where a technical defect by invoicing pig iron under one contract rather than another was disregarded by the court during a market drop; *Daniels v. Morris* (1913) 65 Ore. 289; 130 Pac. 397; 132 Pac. 958, in which during a severe market decline the buyer was required to select 20,000 conforming pounds of hops out of a larger quantity ready and tendered for delivery, the court disregarding the excess weight of some bags.



rightly seen in the circumstances of a particular partial acceptance a clear indication that the entire delivery was actually up to the parties' understanding of the acceptable. Thus, in *Lyon v. Bertram* (1857 US) 20 Howard 149, one of two standard brands of flour equally acceptable to merchants in the area was tendered exship under a contract calling for the other. Two partial deliveries to sub-purchasers of the buyer were made and no objection was raised by the buyer. The buyer's general rejection then followed only when the market suddenly dropped and the court held him liable for the purchase price. Similarly, in *Wrenn v. Lafayette Furniture Co.* (1933) 151 So. 148, 30 bedroom suites were delivered, short 7 chifforobes and with alleged patent defects. Three or four suites were resold at 200 percent mark-up and without complaint by sub-buyers. The buyer's attempted rejection or rescission of the remainder of the shipment for the shortage and for the defects was then held unjustifiable.

A single action of rejection or acceptance does not of course fall strictly within the language of Section 22 on course of performance since these are not "repeated occasions for performance." The policy of the case law is nevertheless left unchanged by this Act because the circumstances of the cases involved interpret the agreement as understood by the buyer, and show bad faith on his part in the attempted rejection. This Act protects only the reasonable actions and reasonable expectations of both parties, as contrasted with sudden objection in bad faith by one which is akin to a penalty or forfeiture imposed on the other.

Where practical construction of a flexible commercial contract results in a *departure* from the literal language of the original agreement which has been shaped and changed by the course of the parties' performance or by a single crucial act of one party, two basic principles must be remembered. In the first place the commercial leeway recognized by the parties in their performance extends only to limiting the privilege of rejection or cancellation and leaves open claims for damages or adjustment for the discrepancy from the literal terms. Secondly, the original agreement can be recurred to and the performance required can be tightened up upon due notice. When there is doubt as to the meaning and effect of the parties' actions in the course of performance, this Act favors that interpretation which stresses the concept of a *waiver of a term* under Section 22. For Section 24 further provides that unless reliance on such a waiver makes its retraction unjust, it is open to retraction with regard to all executory portions of the contract.

Good faith action [p. 18] and expectation are thus protected while flexibility is preserved, not only in the direction of leeway (by action and acquiescence) but also in the direction of tightening up (by due notice given). Thus, while this Act recognizes the right of the parties to reinstate the original terms, it rejects those blinder cases which proceed under the written terms as if there had been no intervening practical construction and therefore no need for notice of an intention to demand stricter performance in the future. [See *Republic Coal Co. v. W.G. Block Co.* (1922) 195 Ia. 321; 190 NW 530, in which parties had dealt loosely with contract terms as to ordering out deliveries and making payments for a lengthy period. The court sustained the seller's sudden cancellation because of one late payment on the ground that prior waivers of late performance had no bearing on this particular late payment which the seller didn't choose to waive. And compare the equally unsound holding in *Southern Coal Co. v. Searcy Transfer Co.* (1922) 152 Ark. 471; 238 SW 624, where during long course of prior dealing between parties under contracts similar to the one in question, extra credit had been extended by the seller. In a rising market the seller's sudden cancellation without notice for the buyer's failure to make prompt payment was held justified by the court despite prior course of dealing.]

Finally, it is important to note that practical construction in the direction of commercial leeway goes not alone to a particular term but to the meaning of agreement as a whole: it is not a single term which the parties are reading liberally but the general terms of the entire agreement. Thus, in the case of *Dow Chemical Co. v. Detroit Chemical Works* (1919) 208 Mich. 157; 175 NW 269, the contract called for monthly deliveries to be spread over the year. The market rose. The first month's deliveries were not called for until January 20, and there shipment was not completed until February 3, both parties being satisfied with this. Then the seller, on the basis of a particular clause, undertook to announce sudden cancellation because of the buyer's failure to pay for the first delivery on the exact day and as upheld in this position by the court. Under this Act, and apart from all other considerations, the loose course of performance in regard to delivery would have required notice from the seller before such drastic remedy could be applied to a negligible delay in payment. Similarly, in the frequent case of successive breaches on both sides, each duly acquiesced in, this Act rejects that line of analysis which sees only breach and waiver, or breach and "holding open," with all ob-

ligations still read as originally written, and with the whole brunt of repudiation resting on whichever party first makes a technical slip without subsequent forgiveness. Under this Act when breach and forgiveness on both sides show general loose construction by the parties, seasonable notice of intention to tighten up is needed in order to justify cancellation for action which in the past was acceptable. (See also Sections 98 through 101 and Comments.)

11. *The pattern of acceptance with adjustment; the consumer exception.* As has been pointed out above, usage of trade, course of dealing and course of performance all tend to indicate that tolerances in deliveries with replacement for partially or wholly unacceptable deliveries or adjustment for goods defective or delayed, are widely recognized in commerce and form the usual pattern rather than absolute rejection, revocation of acceptance, or cancellation. There are, however, lines of trade in which strict compliance with certain [p. 19] terms is insisted upon, as discussed in paragraphs 3 and 7 above, and there are types of purchase in which minor defects go so clearly to the essence that the rightfulness of the rejection is beyond question. This is particularly true in the case of consumer purchases looking to lasting use, for value-in-use to a particular buyer can be seriously impaired by defects which scarcely affect value-in-exchange. So, in the ordinary *consumer* purchase, matters of taste, discrepancy of color, irritation from the noisy operation of a machine, and the like, make exact compliance with the terms essential and justify rejection or revocation of acceptance for minor defects. [Compare also *Williams Transportation Line v. Cole Transportation Co.* (1901) 129 Mich. 209; 88 NW 473, which involved a breach of warranty that a steamer would have a minimum speed and the older rule which limited the remedy to damages was applied. This general rule is rejected by the Original Act, Section 69(1) and by this Act, Section 90 on buyer's rights on improper delivery, and Section 97 on revocation of acceptance.]

Of course, in any event, a rejection is not justified unless there has been a departure from what the *contract* calls for and that is to be determined not only from the literal language of the agreement but also from usages of trade, the surrounding circumstances, the course of performance and prior dealings under the tests and standards laid down in the foregoing. Frequently, however, the authoritative determination of what the contract actually calls for under these principles lies in the future and the seller, at the time of the announced rejection, is never free from the hazard of an unforeseeable adverse judgment by a court and jury. This

Act seeks both to reduce the uncertainty of this situation and to provide the parties with the means of going forward with performance of the remainder of the contract pending settlement of a dispute. Section 77 on cure of tender looks not only to protecting a good faith seller against being caught flat-footed by a surprise rejection but also entitles and enables him to protect himself against the hazards of litigation. For now warned that a possible lawsuit impends, he can make a new tender which he can be certain will comply with the contract in its most technical sense even though the one rejected may have been adequate under the above rules. Section 84 expressly provides that either party may go forward with performance under a reservation of rights which will prevent such further performance from prejudicing his position in any way.

This Act does not adopt, however, any general doctrine of "substantial performance" and *any* discrepancy from what the contract [i.e., the agreement as read in the light of this Act and the law generally, Section 9] calls for is *ground for rejection if the rejection is made in good faith because of the discrepancy*. The principle is two-fold. In the first place, leeways and tolerances in performance are frequently built into the contract itself under the policies discussed above and therefore the so-called discrepancy does not justify rejection because it does not actually represent a departure from the contract terms. In the second place, neither party may be permitted to reject on the alleged basis of a minor defect which is actually of no significance to him when the true reason for his rejection is a change in the market or some similar circumstance which has made the contract unprofitable to him. Such action is clearly in commercial bad faith and not to be tolerated by this Act. [Section 26 (2)]

[p. 20] The better cases have long followed this principle, recognizing that the obligations of a seller under a contract for sale are not all of a single piece. "From a very early period of our law it has been recognized that such obligations are not all of equal importance." *Wallis & Wells v. Pratt & Haynes* (1910 CA) 2 KB 1003. The courts have thus distinguished "dependent" from "independent" promises, "total" breaches which "go to the essence" from mere "partial" breaches; they have often turned to the concept of "collateral" promises or to a distinction between non-compliance which goes to the "identity of the thing" from those which go only to "incidental" attributes. (Compare the results in the cases on "waiver" of unstated defects and of some type of partial acceptance, *supra*, paragraph 9.)

This Act, in Section 101 on rejection of one delivery out of several and Section 97 on revocation of acceptance cuts through all the tortured technicalities of these distinctions but maintains the essence for which these various lines of doctrine have been striving by permitting a *good faith* rejection to be made for any discrepancy. Thus, either party may demand and expect the most exact compliance with the terms where the circumstances of the case or the inclusion of express provisions in the agreement indicate that such compliance is of importance to him. So in the case of the ordinary purchase by the family consumer mentioned above. Neither is a merchant-buyer required to spread the internal details of his business before a jury to be bound by their unpredictable judgment of whether something he did not order is "just as good" or "substantially as good" as what he did order. However, just as this Act recognizes that the buyer's obligation of payment on the due day is more vital when it is due in advance of or against delivery than when it is due after credit (Section 104 on seller's remedies), so it recognizes that there are occasions when certain non-compliance with the seller's obligations do not warrant a rejection. In a few situations the testing of good faith in rejection have been standardized, on the one side, as the case of defect in the form of documents under an overseas shipment contract which is regularly treated as material (Section 44 and paragraph 3 above) and, on the other side, a failure to make a proper contract with a carrier or to give notice of shipment which does not warrant rejection unless material trouble ensues [Section 73 (1) (c)].

In general, however, the application of the principle is left to the particular case. Thus, for instance, where the form of shipment is such as to require the buyer to make a non-burdensome advance of freight charges or to undertake a simple separation of contractual goods from accompanying goods, this Act rejects the bald doctrine of such cases as *Rock Glen Salt Co. v. Segal* (1917) 229 Mass. 115; 118 NE 239, in which the fact that 15 barrels of salt for another person were added to fill up a car of sacks for the buyer was held sufficient to warrant rejection under Section 44 of the Original Act.<sup>[10]</sup> On the [p. 21] other hand, this Act approves the contrary expressions in *Pepper v. Rosen* (1928) 292 Pa. 122; 140

---

[10] On the facts that case was actually well decided, since the seller had not given the buyer appropriate notice of the form of shipment and a fire supervened before the buyer understood the situation.

Atl. 774, in which the buyer was called upon to pay freight charges in excess of amount stipulated in the contract, but this was not held enough to justify rejection; in *William Barker Jr. & Co. v. Edward T. Aguis, Ltd.* (1927 KB 11) 33 Com. Cas. 120, in which the court discussed the distinction between goods "accompanying" a shipment and goods so "mixed with" contractual goods as to cause undue trouble and expense in sorting; and *Daniels v. Morris* (1913) 65 Or. 289; 130 Pac. 397, in which the buyer was required to make a non-burdensome selection from a larger quantity in the warehouse of delivery and the tender was held good.

12. "*Codified*" trade usage; *balanced and unbalanced expressions thereof*. These are days in which the usage of various lines of trade is frequently forced to reshape itself rapidly in order to fit new conditions. Often, the practices developed to meet these new problems compete for a while for general acceptance. Frequently, too, "chiseling" corner cutting practices or lopsided, oppressive usages which are unfair to one side of the bargain develop. Under these circumstances businessmen are more and more resorting to "codified" statements of practice in order to achieve certainty of result, convenient speed in doing business, and to get the benefit of cumulative experience and interpretation. Thus, the "rules" of trade association "standard contracts" prepared and endorsed by a trade association or bargained out by two or more associations, agreed and published definitions or statements of standard grades or terms, association inspection to settle disputes as to the conformity of a delivery to the contract are playing an increasingly important role upon the commercial scene. [See, for example, the standard contracts bargained out between the National Wholesale Grocers' Assn. and the Dried Fruit Association of California for the Pacific dried fruit trade and the consciously favorable interpretation of this balanced and well adjusted contract by the courts in *Rosenberg & Co. v. F.S. Buffem Co., Inc.* (1922) 234 NY 338; 137 NE 609; and *Higgins v. California Prune & Apricot Growers* (1926 CCA 2) 16 F. (2d) 190. See also the Revised American Foreign Trade Definitions cited in the Comments on the sections on Special Mercantile Terms.]

No legal difficulties of incorporation of such codified usage are presented when both parties are members of the association concerned and have agreed to be bound by the published statement. Problems of interpretation do arise as has been demonstrated by the long series of English cases. Under this Act it is recognized that a balanced and reasonable set of provisions of this kind "makes

law” for the members and refines the more general rules of this Act to meet effectively the specialized needs of a particular commodity and a particular organization of the market. Such provisions must be interpreted as favorably and reasonably as possible and the resistance which some courts have set up to the recognition and favorable reading either of trade association “rules” or “standard contracts” is not justified. Thus, in the matter of [p. 22] interpreting standard clause used in the Scandinavian timber trade requiring the buyer to accept deliveries with allowances for discrepancies, this Act approves the approach of Scrutton, L.J., in *Meyer v. Kivesto* (1929 CA) 35 Ll.L.R. 265, requiring the buyer to accept when delivery was in commercially reasonable fulfillment of the contract and of Rowlatt, J., in *Green v. Arcos, Ltd.* (1931 KBD) 39 Ll. L.R. 84, who declared that “some margin is necessary as a matter of business;” and expressly rejects that of the House of Lords in *Arcas, Ltd. v. Ronaasen* (1933) 49 TLR 231, which stated, “If the article they have purchased is not the article that has been delivered, they are entitled to reject it, even though it is the commercial equivalent of what they have bought.”

However, the insistence of the courts on the power and duty of the law to police against the unbalanced and the unreasonable remains as sound in regard to “rules” and standard contract clauses as it does in regard to non-codified usages of trade and the basic principle of this Act against surprise and unconscionability contained in Section 23 and discussed in paragraphs 7 and 8 above, recognizes this power explicitly in the case of contract terms and a fortiori in the case of non-codified usage. For standard clauses while giving certainty to many usages which are still in a state of flux may also legitimately slant their provisions in favor of one of the parties. This does not negate a real assent to the clause on the part of the other party since in using another’s form one agrees to a somewhat favorable slicing of the cake in the other’s favor. Even a non-professional who signs up on the professional’s form without reading it, or indeed without the ability to understand its legal implications if he did read it, must be held to have given a real blanket assent to any *fair* example of the type of contract concerned. But fair dealing goes to the attributes not only of the goods but of the transaction and when clauses are drawn with more onesidedness than is to be expected from a decent dealer, then they enter by surprise and become only in form a subject of agreement. It is such clauses which the courts in the exercise of their police power are justified in striking out.

Two indices are available as a primary indication as to whether a set of standard provisions call for sympathetic and expansive application or for a hostile attitude. *The first index is found in the provisions of this Act itself.* A large number of the protections hitherto commonly sought by clauses are now made available without the need for clauses by this Act which sets forth a body of rights and duties whose prime characteristic is a *balanced* adjustment of the rights and interests of both the buyer and the seller. Thus, in Sections 87 and 88, the seller is granted an exemption for the normal run of supervening casualty and also the privilege of proration among his customers under such circumstances, but at the same time this protection is limited to what is commercially reasonable and this Act does not recognize any indefinite privilege on the seller's part to renew deliveries at his option after the delay. Again in Section 98 either party is protected against the need for performance or preparing to perform if the prospect of counter-performance has become insecure by exercising the privilege of demanding adequate assurances, but sudden termination without notice and without giving the other party an opportunity to provide such assurances is barred. Similarly, this Act recognizes any *reasonable* limitation of remedies but expressly refuses to recognize unreasonable or unconscionable ones [Sections 121 and 122]; it recognizes any *reasonable* limitation on the time for any performance under the contract but insists that the limitation must be "in fact" reasonable [Section 11]. The seller's action for the price under Section 110 may be replaced by the agreement by the right of resale and loss of profit under Section 107 but not by such a clause as "on cancellation by the buyer the seller may at its [p. 23] option mark and hold the goods for the buyer, or ship, and in either case revoke any credit term." Any one or any few of the rules of this Act may be properly modified "by agreement otherwise" in one direction or the other, as the circumstances of the trade or of the parties may seem to require. But cumulative modifications in a single direction raise the suspicion that what they are seeking is not an adjustment of the deal to the needs of the trade or of the particular situation, but rather an overreaching by one party to the contract. True, what seems to an outsider lopsidedness may have warrant in the situation. Thus, a large mail order house ordering radio cabinets on specification may require the most rigorous compliance, piece by piece, and may wish to reject a whole shipment if the single piece that is broken up for testing in detail does not conform; but it is not difficult either to



bring this manner of inspection to the manufacturing seller's *attention* specifically at the time of contracting or to persuade a court of the reasonableness of the procedure and result in the circumstances.

*The second index is found in the origin of the "rules" or standard form.* Where, as in the dried fruit contracts or the lumber usages, both sides have been effectively represented in the building of the "codification," the results are rarely unbalanced, and what may seem to be queer provisions to the outsider usually have a fair and good reason within the particular trade. In most cases, indeed, the balance in standard terms thus arrived at shows on their face.

In view of the difficulty of distinguishing in terse statutory language between such balanced contracts and those contracts built up wholly from and for one side of the bargain, or between statements of practice or "rules" which like those on bankers' letters of credit work a fair balance between issuers of credits and purchasers of drafts under credits and statements of practice drawn for one side only, this Act contains no explicit provision furthering the incorporation of "balanced codifications" into agreements in the absence of special reference to them in the contract, membership of both parties in the associations whose rules or contracts are involved, or the like. Plainly a general section giving *prima facie* weight to such codified usage in the manner of Section 128 on third party documents would open the door to partisan manipulation. Even a provision for their general admissibility subject to showing "the circumstances of preparation" in the manner of Section 127 on published market quotations, would unduly widen and confuse the issues in a trial. Yet the policy of this Act is clear that an agreement must be read in the light of any common basis of understanding of the parties and of what is currently recognized as established in the place or trade [Section 21]. And where "codified usage" is balanced and reasonable, the existence of the codification tends not only to standardize practice in fact but also to standardize the background of expectation and understanding against which men in the trade use language. This Act therefore in no manner interferes with the wise use which courts have made of such "codifications" as giving strong evidence of the currency of reasonable usages, understandings, and details with which the parties may reasonably be considered to have intended to supplement their own brief expressions in the agreement. It rejects, moreover, such narrow holdings as *Hart v. Hammett Grocer Co.* (1918) 132 Ark. 197; 200 SW 795, in which a sale of beans was made by an

exchange of telegrams. The [p. 24] seller's letter confirming the sale stated that it was subject to rules of the bean jobbers' association whose contract specifically defined "delivered" price as used in that trade. The court held that this standard contract was inadmissible to explain the meaning of "delivered" price as used in the telegrams of the parties.

## APPENDIX B\*

## DRAFT FOR A "UNIFORM SALES ACT, 1940" § 69

## SECTION 69. (NEW IN SALES ACT). ARBITRATION OF MERCANTILE ISSUES OF FACT.

Before or after the institution of any litigation involving a contract to sell or a sale of goods between merchants, any issue as to usage of trade, or as to the conformity of goods to what the contract or sale requires and the amount of proper allowance for discrepancy, if any, or as to the substantiality of a breach, or as to the adequacy of assurance of future performance, or as to the mercantilely reasonable character of action taken in cover, may be agreement of the parties be submitted to arbitration, and the results of such arbitration, if duly had, shall be conclusive upon the point or points submitted.

\* \* \*

[p. 73c]

## COMMENT ON SECTION 69. (NEW.)

One cannot follow the course of actual Sales disputes without being struck by the frequency with which *single* issues of fact of essentially mercantile character become crucial, and interfere with adjustment of the whole. And one cannot follow the course of actual Sales litigation without being struck by the expense and uncertainty of litigating just such issues, especially before a jury, but also before most courts. Our political system does not afford an effective way out by way of experts or expert tribunals appointed by the courts; the guaranty is lacking that patronage may not over-balance the needed combination of competence, impartiality, speed and inexpensiveness.

---

\* Reprinted in 1 A.L.I. & N.C.C.U.S.L., U.C.C. Drafts 242, 243 (E. Kelly ed. 1984).

But the submission of *narrow points of fact* to arbitration, especially those narrow points on which competence makes possible speedy and accurate judgment, has never as yet been at all fully exploited, and an Act can properly suggest the possibility to the parties to a mercantile dispute, and should further the effectiveness of such procedure.

As is developed with cogency by Phillips, A Lawyer's Approach to Commercial Arbitration (1934) 44 Yale L. J. 31, the least satisfactory aspect of lay arbitration of whole disputes is the handling of implications, reconciliations, constructive conditions and the like in a complex agreement: this, under use of the Section, is left in the expert hands of the court. \* \* \*

\* \* \*

*In Review* it will now be possible to estimate the degree to which the Draft approaches true expression of the five major lines of a "Uniform Sales Act, 1940," in combination. The Sections which follow contain only relatively minor changes.

*Mercantile standards* are to be set up throughout, and made explicit, being laid down, however, only for mercantile cases; and rights on breach are to be sufficiently sharpened to let lines of safe and business-like *action* be determined. *Mercantile procedures for adjustment* are to be initiated by mercantile admeasurement of obligation, and then carried through to give every drive to minimize dispute, ease negotiation, and avoid risk of loss or prejudice by offering negotiation. In full consonance with both these lines of attack, the integration of theory undertaken in the original Uniform Sales Act is to be worked into full expression, and the best case-law around and under it is to be worked with it into a harmonious whole. Finally, points of legal remedy are to be sharpened somewhat, and the alternative remedy of cover is to be inserted to substitute mercantile clarity for the obscurity and non-conformity of the law of damages. And *an even balance of buyer's rights and seller's* is vital.

It is essential to emphasize again that so much of this as has been achieved would have been unthinkable without the impetus and labors of the Merchants Association and Hiram Thomas, and without the critical work done on the Federal Bill, to say nothing of the literature of the last fifteen years.

## APPENDIX C\*

REVISED UNIFORM SALES ACT, SECOND  
DRAFT (DEC. 1941) §§ 59-59D

## MERCHANT EXPERTS ON MERCANTILE FACTS

## Introductory Comment to Sections 59-59-D.

A. *General.* The need for speedy, reliable, and therefore reasonable and reckonable, determination of questions of mercantile fact underlies all Sales law. The unspecialized character of our Courts brings it about that few judges have the specialized skill in such matters of a Kennedy, Hamilton, or Scrutton, of the English Bench; and juries are notoriously out of touch with such matters.

Yet the Act of 1906 made the effect of the transaction subject at every turn to the usage of trade: the only proof of which is by experts. And such questions as conformity of textiles to a requirement of merchantability can take three weeks merely to prepare for trial.

[p. 532]

The present Draft opens the transaction still more to questions of mercantile fact. That is needed. But certainty in transactions, certainty in negotiations, and reasonable insurance against the mercantile tricks of the business chiseler and the jury tricks of the legal chiseler, are not to be had without a sound and workable procedural device to get such questions of mercantile fact settled competently. Incidentally, competent settlement means settlement which is also (1) speedy; (2) inexpensive; (3) reckonable.

That this is workable, is demonstrated by the work of the arbitration committees of particular trades. That it has been workable in court, was demonstrated as early as Mansfield, with his recourse to a special merchants' "jury"; and in a somewhat different fashion by the satisfactory work of experienced commercial judges when passing on either law or fact in a commercial case.

---

\* Reprinted in 1 A.L.I. & N.C.C.U.S.L., U.C.C. Drafts 531-37 (E. Kelly ed. 1984).

The procedure laid down in the sections attempts, without the need for an established "arbitration committee" in any trade, to open the submission of peculiarly mercantile questions of fact to skilled specialists. It attempts to avoid abuse by misguided patronage. It attempts to set the proceedings in a framework of sworn joint, skilled work, under direct control of the court, with a duty of unanimous finding, which will offer a very considerable counter-weight to the tendency of the seller's choice to be the seller's "man." It attempts to further fair judgment by limiting the questions to questions which have a reasonably objective basis in trade practice, so as to induce a common standard of judgment: a matter of real moment, in a discussion within such a tribunal. It attempts to give to the finding such weight as can be counted on to seriously influence any jury or court later trying the whole case, and thereby induce settlement and avoid long drawn out litigation.

Above all, however, it attempts to offer to parties, and to their counsellors, *in advance*, [both in the cases which now are left in dark doubt until verdict, (usage; and quality; value of discrepancies) and in the cases where mercantile practice needs to be further drawn into account (cover, substantiality of defect)] a higher degree of safety and reckonability than has been available in our law since Mansfield's jury, or the occasional special commercial courts which have existed. Indeed, a special "commercial" court would not, and could not, today be abreast of the commercial practices of a hundred varied trades, as it could a hundred years [p. 533] ago be abreast of "the commercial practices" of a whole city or area. As the specialized trade tribunal shows, it is *specialized* knowledge and competence which are needed.

It is to be further noted that the *law* about the effect of "business custom" is quite as uncertain as are the jury-verdicts. That has not been because any sane Court has for half-a-century doubted the wisdom of fully incorporating the relevant usage of trade into the agreement and into the decision on adequacy of performance—if there had been any reliable way of determining what the usage of the trade really was. But Court after Court has felt the extreme uncertainty involved in submitting such ques-

tions to a jury of schoolteachers and men of crafts and trades not concerned in the case. And has in consequence found, "in law," that "custom cannot alter the law of the land," or has laid down such stringent tests before "a usage is such as to bind both parties" that few of the existing usages daily relied on in commerce could satisfy the test. The only answer is a reliable procedure.

B. *Detail.*

(1) *Selection*: The aim is to assure any party that he will have a man or men on the special tribunal, whom he believes competent. The danger is partisanship. The circumstances of the special questions involved, of the atmosphere, and of the skill of the other men with whom the question is discussed, are believed to give a higher guaranty against this than is afforded in the procedures available under existing law. With this, goes speed in presenting and weighing the evidence.

(2) *Unanimity*: Even when the result may sometimes mean compromise, it is believed to be necessarily, under the circumstances, a compromise within unusually narrow limits, and one materially more mercantilely sound than under present practice.

(3) *Failure of unanimity*: The sections are intended to be broad enough to allow the Court to direct the selection of a new tribunal, where that seems a hopeful procedure. But the danger of the hung tribunal is not believed to be great.

(4) *The use of the finding*: All question of constitutionality is believed to be here avoided. But it is believed that few petit juries could be induced to disregard the special finding.

C. *What is essential is not the particular procedure here put forward.* What is essential, is the provision of some adequate tribunal to determine competently and reckonably all questions of fact which rest in special knowledge of the trade.

[p. 534]

Without that, certainty in Sales counseling, as in Sales litigation, will *continue* to be absent.



\* \* \*

Section 59. (New to Sales Act.) *Submission of Mercantile Facts.*

(1) In any action arising out of a sale or a contract to sell between merchants, any issue or issues involving any of the following matters may on motion of either party be submitted specially, under Section 59 through 59-D, to merchant experts—

(a) The effect on the terms or conditions of the sale or contract to sell, of mercantile usage, or of the usage of a particular trade;

(b) The conformity or non-conformity in quality, routing, or any other mercantile aspect of any delivery, to the duties or conditions resting on the seller, and the measure of the discrepancy, if any; and whether any defect in performance has been substantial;

(c) The mercantile reasonableness of any action by either party, the mercantile reasonableness of which is challenged;

(d) Any other issue which requires for its competent determination special merchants' knowledge rather than general knowledge.

(2) The sections on merchant experts are to be liberally construed, as being remedial, so as to effectuate their general purpose to accomplish speedy and competent determination of questions of fact which fall within the field of special merchants' knowledge, rather than of general knowledge.

\* \* \*

Section 59-A. (New to Sales Act.) *Demand for Experts and Settlement of Issues.*

(1) Notice that merchant experts are demanded must be given to the opposing party within [ten] days after the case is put on the trial [docket].

(2) Such notice shall contain a statement of the issues of mercantile fact which the demanding party desires to have submitted.

(3) Within five days the other party must give to the demanding party notice of any other issues of mercantile fact which he desires to have submitted.

(4) On motion of either party, the court shall then set a time, and shall settle the issues of mercantile fact

in writing and approve them. The trial shall be stayed until after conclusion of the proceedings of the merchant experts; but those proceedings shall be had as early as is feasible.

(5) The court may, for good cause shown, alter or enlarge [p. 535] the times set in the sections on merchant experts, give dispensation for delay, or admit to settlement new issues or new phrasings of issues; but not in such manner as to permit surprise. Nor shall new issues be settled, save by consent of both parties, after any merchant experts have been appointed.

\* \* \*

Section 59-B. (New to Sales Act.) *Selection, Definition, and Organization of Merchant Experts.*

(1) Within five days after the issues have been settled, the party demanding submission shall select one, or two, disinterested merchants deemed by him qualified, and who consent to serve, file a statement of their appointment with the court, and notify the other party of their appointment.

Such merchants are known in this Act as "merchant experts."

(2) Within five days after receipt of such notification, the other party shall select a like number, and in like manner file and notify.

(3) The merchant experts selected shall agree upon an additional one.

(4) If no statement of appointment is filed under subsection 2, or if no agreement is reached within ten days under subsection 3, or if the court disqualifies any merchant expert, for cause, the court shall appoint.

The court is directed, in its action under this subsection, to take into account the existence of any trade association or arbitration association having special panels, which may be available. If the parties agree upon a panel, the court shall appoint from the panel.

(5) The merchant experts shall receive no compensation, except under agreement of the parties. If the parties agree to compensate the experts, the compensation shall be taxed as costs.

(6) The parties may agree upon a single merchant expert. If they do, his determination of the issues submitted is conclusive.

\* \* \*

Section 59-C. (New to Sales Act.) *Hearing and Determination.*

(1) The merchant experts shall be sworn to act not as party representatives, but as a special sworn expert tribunal to find the true facts.

(2) They shall sit with the court presiding at the hearing, and shall render a unanimous finding on each special issue submitted, which finding shall be reduced to writing.

[p. 536]

(3) If unanimity on any issue cannot be had, the court may order a new tribunal of merchant experts to make a finding with regard to such issue. [*Addendum*, Subsections (4) (5), at p. 288.]

Comment on Section 59-C. Only experience can tell how great the possibility—or danger—of the hung tribunal is. It is, however, the advance opinion of many, when the issue is narrow, and technical, and is an issue on which specialized knowledge is clear, that men in a trade are extremely likely to be able to get together on the fact; and that the arguing position of a man who is out-of-line with actual practice, rapidly becomes untenable. This goes to the possibility of the “seller’s man” or the “buyer’s man” becoming stubborn in an unreasonable and disruptive position.

There remain two other bothers. One, in a small community, is local merchant politics, “influence”, the possibly dominating character of a single, but unreasonable “big man”. The other is the precise opposite: the failure of local informal pressures toward reasonableness and decency in judgment to reach an “imported” expert.

The Committee and Section feel, however—and the Conference during informal reference to these sections seems to feel also—that no possibility of evil is presented which is not present in far greater degree with a lay jury; and that the possibility or even probability of gain is

great. Finally, experience with commercial arbitration suggests very strongly indeed that a sworn group, especially if sitting under a court, is likely to develop a strong semi-judicial conscience. And disqualification for interest is available.

It will be noted, in passing, that the machinery proposed has no precedent-building character: The *fixing* of trade practice and standard is believed to be properly a task for associations. The task here is to assure counsellors and buyers and sellers of an *informed* judgment, after the event, as to what trade practice, trade understanding, or the mercantilely reasonable, comes to; so that both the making of a contract and action under it, have some reliable basis to reckon with.

\* \* \*

Section 59-D. (New to Sales Act.) *Use of Finding at Trial.* In any general trial of the issues between the parties—

(1) The special finding of the merchant experts shall be received in evidence, and shall be sufficient to sustain a verdict.

[p. 537]

(2) The court shall instruct any jury in such trial that the special finding is the expert determination of a special tribunal of sworn merchant experts constituted under the law to pass as experts on the particular issues concerned, that each party appointed (or had opportunity to appoint) to that tribunal an expert (or two experts) deemed by him competent, and that the special finding was unanimous; but that the finding can be disregarded by the jury if they can in conscience disregard it.

(3) None of the merchant experts who made the finding shall testify as an expert in the same case, nor be examined as to the basis of the finding.

\* \* \*

Comment on Section 59-D.

(1) The form and substance of this section are believed to avoid all constitutional difficulty, especially such as may relate to trial by jury.

(2) It has thus far been assumed that the merchant experts' part in the picture is a portion of the *litigation*;

so that an effective arbitration clause would displace them, as it would displace the whole litigation. The matter deserves thought, however, as to whether the values of such a special tribunal can be made available in any arbitration which occurs before arbitrations *who are not themselves experts in the trade concerned*.

## APPENDIX D\*

TRANSCRIPT, N.C.C.U.S.L. FIFTY-SECOND  
ANNUAL CONFERENCE, AUG. 18-22, 1942,  
DISCUSSION OF REVISED UNIFORM SALES  
ACT, PROPOSED SECTIONS ON MERCHANT  
JURIESSection 59. *Submission of Mercantile Facts.*

(1) In any action arising out of a sale or a contract to sell between merchants, any issue or issues involving any of the following matters may on motion of either party be submitted specially, under Sections 59 through 59-D, to merchant experts—

(a) The effect on the terms or conditions of the sale or contract to sell, of mercantile usage, or [p. 124] of the usage of a particular trade;

(b) The conformity or nonconformity in quality, routing, or any other mercantile aspect of any delivery, to the duties or conditions resting on the seller, and the measure of discrepancy, if any; and whether any defect in performance has been substantial;

(c) The mercantile reasonableness of any action by either party, the mercantile reasonableness of which is challenged;

(d) Any other issue which requires for its competent determination special merchants' knowledge rather than general knowledge.

(2) The sections on merchant experts are to be liberally construed, as being remedial, so as to effectuate their general purpose to accomplish speedy and competent determination of questions of fact which fall within the field of special merchants' knowledge, rather than of general knowledge.

Section 59-A. *Demand for Experts and Settlement of Issues.*

(1) Notice that merchant experts are demanded must be given to the opposing party within [ten] days after the case is put on the trial [docket].

---

\* Reprinted in N.C.C.U.S.L., *Archives Publications*, Microfiche 32.0-B(2) (1983).

(2) Such notice shall contain a statement of the issues of mercantile fact which the demanding party desires to have submitted.

(3) Within five days the other party must give to the demanding party notice of any other issues of mercantile fact which he desires to have submitted.

(4) On motion of either party, the court shall then set a time, and shall settle the issues of mercantile fact in writing and approve them. The trial shall be stayed until after conclusion of the proceedings of the merchant experts; but those proceedings shall be had as early as is feasible.

(5) The court may, for good cause shown, alter or enlarge the times set in the sections on merchant experts, give dispensation for delay, or admit to settlement new issues or new phrasings of issues; but not in such manner as to permit surprise. Nor shall new issues be settled, save by consent of both parties, after any merchant experts have been appointed.

[p. 125]

Section 59-B. *Selection, Definition and Organization of Merchant Experts.*

(1) Within five days after the issues have been settled, the party demanding submission shall select one, or two, disinterested merchants deemed by him qualified, and who consent to serve, file a statement of their appointment with the court, and notify the other party of their appointment.

Such merchants are known in this Act as "merchant experts."

(2) Within five days after receipt of such notification, the other party shall select a like number, and in like manner file and notify.

(3) The merchant experts selected shall agree upon an additional one.

(4) If no statement of appointment is filed under subsection 2, or if no agreement is reached within ten days after subsection 3, or if the court disqualifies any merchant expert, for cause, the court shall appoint.

The court is directed, in its action under this subsection, to take into account the existence of any trade association or arbitration association having special panels,

which may be available. If the parties agree upon a panel, the court shall appoint from the panel.

(5) The merchant experts shall receive no compensation, except under agreement of the parties. If the parties agree to compensate the experts, the compensation shall be taxed as costs.

(6) The parties may agree upon a single merchant expert. If they do, his determination of the issues submitted is conclusive.

Section 59-C. *Hearing and Determination.*

(1) The merchant experts shall be sworn to act not as party representatives, but as a special sworn expert tribunal to find the true facts.

(2) They shall sit with the court presiding at the hearing, and shall render a unanimous finding on each special issue submitted, which finding shall be reduced to writing.

[p. 126]

(3) If unanimity on any issue cannot be had, the court may order a new tribunal of merchant experts to make a finding with regard to such issue.

Now there comes on page 288 at the end of what is on that page, a section 4 and 5.

(4) In the interest of speed, accuracy and completeness of presentation, the court may relax or dispense with the rules of evidence in the hearing before the merchant experts, so far as the court may deem wise.

(5) The rulings of the court are subject to review, and may be reversed either because there is no evidence to sustain the finding, or because the net effect of the conduct of the hearing has been materially prejudicial.

Section 59-D. *Use of Finding of Fact.*

In any general trial of the issues between the parties—

(1) The special finding of the merchant experts shall be received in evidence, and shall be sufficient to sustain a verdict.

(2) The court shall instruct any jury in such trial that the special finding is the expert determination of a special tribunal of sworn merchant experts constituted under the law to pass as experts on the particular issues concerned, that each party appointed (or had opportunity



to appoint) to that tribunal an expert (or two experts) deemed by him competent, and the special finding was unanimous; but that the finding can be disregarded by the jury if they can in conscience disregard it.

(3) None of the merchant experts who made the finding shall testify as an expert in the same case, nor be examined as to the basis of the finding.

Now this rather elaborate and perhaps cumbersome machinery is before you as a whole and some of the major doubts about it should be first called to your attention before you go into the discussion of it. Also, I think some of its major hoped-for values should be placed before you. The situation is that in that extremely difficult field of conformity of goods to quality, it takes an expert, except in a gross case, to know what is what, to read the contract and see what is called for [p. 127] and to size up whether the goods are as they should be. A simple matter like a suit about the quality of goods like this [indicating] can take three months to prepare with expert witnesses. You bring it in to the same experts, not as witnesses, but as judges, and they look at it like this, and they say, "That ought to be a five-cent allowance."

MR. LANE: Can the jury believe or disbelieve the judges?

MR. LLEWELLYN: This tribunal—its finding can be disregarded, if the jury wishes to disregard it.

MR. LANE: Then their judgment is not final?

MR. LLEWELLYN: Their judgment is not final. That, we think, is essential to constitutionality, that the judgment shall not be final. That is point number one.

Now the next thing has to do with a large body of questions which in the law as it stands, and so in the act, are set up in terms of the standard of the reasonable, and we find that when courts or even juries deal with the standard of the reasonable in mercantile transactions they sometimes do it very well and they sometimes do it very blindly indeed. If a court happens to be a real-estate-minded court and thinks like a real property lawyer, the results of what it will see as reasonable or unreasonable

in a sales transaction will sometimes raise the hair. If, on the other hand, the court happens to be a mercantile-minded court, it will give you very lovely results. But the one outfit that you can rely on to know what looks reasonable to a business man is a business man in the same trade.

Finally, when it comes to a question of what is or what is not settled usage of the kind which should be read into every contract because it is the presupposed background, the only people who know what is a settled usage are the people who are in the middle of it, working under and with it, and who can tell what it really means.

To get such questions settled then by people who are really competent, who can do it fast and who have a very reasonable likelihood of agreeing—to that I want to come in just a minute—has seemed a wise line of attempt.

Now, when you set up your tribunal, take from this side and from this side and from the middle, are you not going to be faced with a purely partisan affair, with the seller's man digging in at all costs for the seller, and the buyer's man digging in at all costs for the buyer? We believe not; first, because of experience with commercial arbitration. That has not proved to be the result in commercial arbitrations. Commercial arbitrations do indeed involve a very considerable [p. 128] amount of compromise result, but the range of the compromise is a rather narrow range so far as experience can be gathered on the point. The reason for that, we believe, lies in the fact that you have not got a jury situation. You have got a situation of experts in trade, and the range within which a man can save his face and be really unreasonably partisan is a narrow range. When a man goes in to defend the seller at all costs or the buyer at all costs, and the man across the table says to him, "Do you mean to say you are willing to pay 78 cents for that kind of goods? If you are, I have got a lot I will let you have," the range of arbitrary disagreement becomes materially smaller than when it is simply a question of how long an unreasonable juryman can hang out in a closed jury room and fight.

Against that background, then, we have these sections.

Now, the first problem is that of unanimity on which I have already touched. Is it necessary? I don't know that

it is necessary. I am clear that if it is workable, it is highly desirable. I am clear that the pressure on men, to get together under the circumstances, tremendously increases if they have either got to flop or get unanimous. On the other hand, Mr. Pryor points out, and points out cogently, that to require unanimity makes deliberate hanging of the tribunal possible and that that is a wonderful stalling procedure, and that when you have a majority view, at least it is a majority view and ought to be used for what it is worth. It may not be as potent as a unanimous one but it will at least be worth a good deal if the case moves on to trial.

That is the kind of thing we want advice on. We want advice on the question of whether this is constitutional. Some of our men have doubts about it. For myself, I think this is constitutional.

MR. LANE: Wouldn't it be a monstrosity to have some laymen seated on the bench of the court in a matter of this kind and have arbitration and court procedure so badly mixed up? Why not separate them?

MR. PRYOR: I don't think it would be a monstrosity. I think it a procedure that is certainly a unique and distinct innovation in the trial procedure, but I take it that it is designed to, and I think would go a certain way, toward meeting of the criticism that has been levelled at the courts and the administration of justice in litigation of this character. It is an approach in that direction at any rate, I think.

The only criticism I would have is the one that Mr. Llewellyn has suggested. It seems to me that if the opinion of these experts is worth something in the trial of the case, it is admitted as an advisory proposition by the court [p. 129] and the jury, the opinion of the majority and of the minority, the court could just as well say, instead of saying they have unanimously found so and so, that two of the three members have found so and so, and the others find so and so. That is worth something to the jury and it is worth something to the parties in the litigation to have that situation presented, it seems to me. I don't think there is any question of constitutionality.

MR. STANLEY: I just wonder. Has the Committee given consideration to the proposition that if this demand is made, that the selection be made by a court? It seems to me that you have got a situation there which would carry a lot more weight, since it ultimately is submitted to the jury. The parties then the court having selected the experts in the particular trade or business, it then becomes advisory to the court. They are not being picked by somebody. While I think that there is probably some merit to what you say with respect to the range of disagreement being small, yet some of these people that get into court might pick somebody under definite instructions to stay put, maybe their particular kind of a merchant. It seems to me that your machinery here is one of the best things in a statute that would appeal to businessmen and merchants, would relieve the talk about the slowness of the administration of justice, the rotten jury system and a lot of other things that we are hearing all the time. But it comes back to me on the desirability, if this is asked for by the merchant and you put him in a position to get the very thing he has been howling about, that is competency for the decision of mercantile facts, then the court ought to pick that as an advisory group of three and divorce it from this "you pick one, I pick one, and we'll pick a third one." I just ask the Committee to consider that because it seems to me that it makes the machinery operate smoother and adds a great deal to the whole procedure.

MR. LLEWELLYN: Mr. Stanley, the Committee has thought about that very hard and if this country were blessed in all its lines of trade with reasonably well-balanced and reasonably well-organized trade associations, there would be no question that one could go at it that way with satisfactory results, requiring the court to choose probably from a panel set up by the association. The trouble is that the organization of the available businessmen to be picked from who have standing and are known, is too spotty to be a reliable background, in general.

The second trouble is that while this is uncompensated work, we believe that to be quite essential to keep this from just being a scramble, it is my belief that to do this kind of work with any type or regularity would be for

him a source of great prestige as a semi-judicial capacity and the type of thing in regard to which the appointment of friends, especially of the more worthless and leisured variety, whose leisure represents, [p. 130] not retirement at the end of long experience, but unwillingness of other folks to keep them busy, presses upon the court.

Now, I don't know how it is in your part of the country, but I know that in our part of the country there are too many judges that are looking for that kind of favor-giving power to make merchants feel comfortable if they didn't have a hand in putting their own man on the tribunal. Faced by the two choices, we have turned to the one on which there is experience. These arbitration tribunals do get set up and do work out along these lines.

MR. HARNO: The procedure outlined here I have a great deal of enthusiasm for. I have something to say in opposition perhaps or at least in criticism of them, but I want to say that they provide a method of getting at facts which we sorely need in the law. I think if there is any one criticism that stands out against our legal procedures, it is the way we determine facts in a court of justice. If a merchant or a detective were to get at the facts he would go out and find them, and find them in the best way he could, and it is our procedures that put us in disrepute.

Now here you have a procedure provided in which experts who are familiar with the trade, familiar with that business, sit and attempt to reach a settlement. They ought to be able to reach it much more rapidly than a jury could, which knows nothing about the issue under dispute, because they have a backlog, a background of knowledge, on which they can move rapidly to a decision, and so I see here something that is coming, I believe; that is, the method of determining facts. We already are approaching it in some of our other agencies that are quasi-legal, in the commissions. Sooner or later the courts and our court procedures are going to take up that method of determining issues.

I wonder whether we can ever get it by a legislature, with the personnel of a legislature as I know legislatures. I know the difficulties we had in connection with the Expert

Testimony Act because our legislatures were not prepared or ready to accept an Expert Testimony Act under which the court could appoint the experts.

I feel that the Committee might wish to give further consideration to experts appointed by the court, but perhaps they have hit upon the best method. I am somewhat interested in the fact that each party is to choose disinterested experts. I just can't quite conceive of anything like that if they are choosing experts. They would probably choose experts that were favorable to themselves, but I suspect if they chose experts and they got around a table they could come out with some sort of a decision.

[p. 131]

I am not quite sure, as Mr. Pryor seems to be, that this is constitutional. You provide, Karl, in Section 59-D, subsection 3, that none of the merchant experts who make the findings shall testify as an expert in the same case nor be examined as to the basis of their findings. Now you are very definitely eliminating cross-examination, and if there is anything that has been deeply ingrained in our rules of evidence, it is the privilege of cross-examination, and you have under this provision taken away the privilege of cross-examination from the opposition.

MR. THOMAS: When I first read these sections, I was just as favorably impressed with them as anybody in the room. I know the difficulties of trying these commercial cases, particularly on questions of quality. That is not the only issue that will be submitted to these experts. They will pass on questions of mercantile usage or the usage of a particular trade. They will pass on not only nonconformity in quality, but routing, which sometimes is a question of law, or any other mercantile aspect of any delivery. "With the duties or conditions resting on the seller, and the measure of the discrepancy, if any; and whether any defect in performance has been substantial;" and it is contemplated that these merchants shall use their own knowledge and not be bound by any evidence in the case. That is outstanding. They cannot be examined at all. They can't testify. There is no way of testing their knowledge.

It has been my experience and the experience of any other trial lawyer in commercial cases that when you come to a question of trade usage you will nearly always have opposing experts. One will testify, or one group will testify with the utmost confidence that a certain practice is universal in the trade and then the other party will call an equal number of experts and say that it is not universal. I have had that experience and I guess anybody that has tried these cases has had the same experience. You come to cross-examine a witness who testifies to a usage and very often his testimony shows that there is no usage. He believes there is because in his particular firm they follow it, but when the evidence is all in, there isn't any usage.

Now, there is the value of cross-examination. You take one member of this merchant's tribunal who is of a domineering type and he may come out with a finding, persuade the others to join him, that there is a usage, when none exists at all.

There are some of the practical difficulties. Partisanship can't be avoided. I concede that in arbitration those things get on very well. There still is partisanship there, but the merchants put up with it.

Here you have the constitutional right of jury trial involved. You have two outstanding features in this proposed [p. 132] procedure. One is that at the motion of either party the procedure is mandatory. If the other party doesn't appoint his experts, the court shall appoint them. If the experts appointed can't agree on another expert, the court shall appoint him. That means "must." In a sense, it is a compulsory arbitration of the particular issues which are to be submitted to those experts.

I can't speak for the country at large, but we have in New York this provision of our constitution: "Trial by jury in all cases in which it has heretofore been guaranteed by constitutional provision shall remain inviolate forever, but a jury trial may be waived by the parties in a manner to be prescribed by law." Now this is certainly not a waiver of a jury trial because it is compulsory.

To the extent that these merchant experts rely on their own knowledge and experience in making their findings, and that seems to be unquestionably contemplated, they cannot be interrogated as to the basis of their findings.

There may be evidence in the case, for instance, as to a trade usage. So far as I can see, they are not bound by that. They make up their minds on what they know or think they know. If the jury is not bound by the findings of these merchants, then the local procedure falls. If the jury can accept the evidence that is offered and reject the findings of the merchant tribunal, the object of the procedure is frustrated.

Now the kind of instructions to the jury which this statute contemplates are practically binding instructions because they are made to depend on the question whether the jury can in conscience disregard the findings of the merchant tribunal, which is a test, so far as I know, that is unknown to the law.

I think it is a general rule, I know it is in New York, that the testimony of experts giving opinion evidence—and much of the issues which will be submitted under this procedure are pure opinion—testimony of experts giving opinion evidence and subject to cross-examination is not binding on the jury even if it is uncontradicted, and on proper request the court must so instruct the jury.

It often happens in the trial of cases that one side will call an expert whose testimony is so preposterous that the other side doesn't call any expert to contradict him. It may be that the jury isn't aware of the fact that the testimony is preposterous, but they have an opportunity under proper instructions of the court, to throw that expert testimony out of the window, and very often they do.

To the extent which these merchant experts make findings which are not based on evidence in the case, they are [p. 133] invading the province of the jury. If the jury is given anything like an instruction to follow their findings, again the province of the jury is being invaded. As a matter of fact, as to every issue which is submitted to these merchants, the province of the jury is being invaded.

Now, I like to see mercantile questions determined by merchants, but this procedure enables the merchant tribunal to give findings which would not stand up under cross-examination and the jury is abdicating its functions. I cannot see, for the life of me, why that procedure does not violate the right of trial by jury as guaranteed by the New York Constitution, and I am very much impressed



with the denial of the right to cross-examine these experts as to the basis of their findings as well as the provision which keeps them from being witnesses. That is the only way that truth can be established, that is, by cross-examination. A man may think that there is a trade usage. He may be perfectly conscientious about it, though when his eyes are opened, he will have to agree himself that there isn't any usage that is binding. There is no way of getting at the basis of the findings of this merchants' tribunal. It just stands, that is all. You can't inquire into it. That is the vice of the thing. The jury, if this procedure is going to be any good, has just got to abdicate its own functions. Credibility of witnesses that testify about the very things that are submitted to the merchants, the jury is supposed to pass on that, but if they find that the witnesses' testimony is acceptable and the merchants' tribunal comes in with a contrary finding, what are they going to do? I would say that if the witnesses are competent as the men selected for the merchants' tribunal, it would be the duty of the jury to follow the testimony of the witnesses which is tested out on cross-examination and not accept the *ipso dixit* of the merchants' tribunal. The denial of the right of interrogating these witnesses comes pretty near to violating due process.

You take a case where, for instance, a trial judge, if he is sufficiently daft and refuses to the defendant the right to cross-examine the plaintiff's witnesses and a verdict is rendered for the plaintiff and judgment entered on the verdict, that judgment is not merely erroneous, it is void, contrary to due process of law. That is what I am afraid of in this thing. I can't justify it. I wish to heaven we had some such tribunal. We have it in mercantile arbitration and it works fairly well, but I don't believe that anybody reading this and lining it up with this provision of the New York Constitution which is common among states, could help but be impressed by the fact that this does invade the province of the jury. I don't like to come to that conclusion. Take, for instance, due process. If the right of cross-examination or examination at all is denied with respect to those merchant experts whose findings are expected to be controlling, that seems to me to violate the fundamental principles of due process. You can't inquire

[p. 134] into it at all. As I said before, very often these fellows are mistaken. We have seen it demonstrated in court time and again. Whereas if they were subject to examination, they are intelligent men, they would see the point at once. About half the merchants I have talked with, and I have talked with a lot of them, actually don't know what a usage of trade is, according to the legal rules. That is the thing you are up against. They are not subject to any instruction from the court. They go ahead on their own. That is what is contemplated.

Of course, in a commercial arbitration, the theory of the law is that the arbitrators can commit only one error at law and that is excluding relevant evidence. That is the only error they can make. Bias, fraud, something of that kind is out, but they can make an award which on the evidence before them is wrong on the facts and wrong on the laws and the court won't do a thing to it. They will let it stand. That is a chance the merchants take. They are perfectly willing to take it. I don't argue against it at all, but when you inject that element into a lawsuit, you are doing something that imperils the right of trial by jury. I am very much afraid of it.

Your due process of law requirements—they are aimed not merely at the state legislature but they are aimed at the court. I don't see how this procedure can stand. Even if the jury were instructed to give the findings of these merchants only such weight that they would give to any other evidence, that wouldn't cure it, because it isn't evidence. It has never been given any of the tests by which evidence must be tested. I regret that I have to come to that conclusion, but I am forced to it.

MR. TEISER: I don't know how many of the Commissioners come from timber states, but I have in mind a sale of timber. I have had so many litigations about it. There are expert timber estimators, and I think Mr. Llewellyn probably coming at one time from Oregon or having some connections in Oregon, if he knows anything about timber estimators or timber cruisers who are experts, knows the variance that happens between timber experts for buyer and seller. It is almost a trite saying amongst us that "you can get a timber estimator to estimate timber upon the

land, or the quality of timber upon the land one way or the other by merely telling him whether the person employing him is buying or selling." If he is representing the buyer, the timber estimate will be low. I am not saying this unkindly about timber estimators, because some of the timber estimators are my friends.

MR. LLEWELLYN: I have even known lawyers whose judgment of the law was somewhat dependent upon which side of the case they were on.

MR. TEISER: I have, too. But especially I am speaking about getting an expert who will be afraid to say this or [p. 135] that or the other thing about the quality of goods, doesn't stick with timber people, at least. I had a litigation in Chicago where experts got on the stand and testified as to the growing trees on a piece of land that differed to the extent in value of over a million dollars between them, and it wasn't such a big piece of land either.

However, I am just giving that as one of the many things outside of what we usually think about mercantile practices and so forth, because that is a sale of personal property. That is true not only in the quantity of timber but in the quality of timber, whether it has bugs in it and so forth, as we call them, and there are many things in that regard which I am certain that if you expect unanimity of opinion, of determination, you would never get it in the world. If one had a question of sales of timber and I appointed for my client or my client appointed himself a timber estimator on one side and a timber estimator on the other side, and they picked a third, there would be exactly three determinations and not one, and there would never be unanimity and the case would never end and would stay in court almost forever. I can see it being used by a man who wanted the case to stay in court forever, because in that kind of a case it would stay in court if you want unanimity.

I think this section has a germ of excellency; I really do. I think in idea it is excellent and I think it can be worked out, but in the first place I think you have got to get away from unanimity. You have to have a majority judgment or verdict or determination by those experts,

whomever you employ. Secondly, I don't believe that that opinion should be anything more than advisory, or the determination to be anything more than advisory, and in doing that you will get away from the difficulty of constitutionality, I believe. In other words, if you make this required, and it will be required if either party may do so, and permit a majority determination with that majority determination going to the jury, not as binding on them, and it isn't binding, except when you say that if in conscience they can do so—that is a phrase that is pretty hard to get around or understand what it particularly means. More than that, you would have to, I believe, give the right somewhere in your statute to cross examine somebody—the man who makes the verdict or the man who comes to the judgment or perhaps those who came to a contrary judgment. But with those situations taken care of, I believe you could have a quasi-arbitration or quasi-determination and yet work out things within constitutionality and practicality. But I don't believe in any sense you will get anywhere if you are going to require a unanimous determination or make the determination when made binding to the extent that you have made it binding. I realize that there are some qualifications there as to the bindingness of it, and I do believe that cross-examination should be permitted. With that you have done a lot. You have saved a tremendous amount [p. 136] of lost motion with that kind of a section. I do call your attention to the fact also that in section 59-C you provide that these people may have a hearing but you don't say whether they can summon witnesses, whether the witnesses must be sworn or how. I think it has to be implemented to that extent also.

PRESIDENT SCHNADER: I think this may be the best procedure in the world but I don't think it has any place in the law of sales or in the commercial code. We are preparing a uniform state act and there are at least, I suppose, half the states that still have constitutional provisions requiring an act to relate to one subject, and I think at least in Pennsylvania we couldn't pass this act because it would be held that this part of the act relates to procedures and not to the substantive law of sales. I

think it would be very dangerous to try to hook up those two things in this one act, all else apart.

Then the second thing about which I would like to hear the frank views of the members of this conference is, in how many of their states do they think that an act could be passed which contained this procedure? I suspect that in forty-five out of forty-eight states this procedure would mean a delay of possibly ten years in getting the sales act passed. I think a great deal of educational work must be done before even the members of the Bar would advocate a procedure of this sort. Now it may be that if the prominent merchants associations, trade associations, were all behind it and for it and demanded it, that would change the picture, but I doubt whether that situation exists. I certainly think that we ought not to wrap up in one package a procedural reform, however good, with the substantive law of sales and the other subjects which go into a commercial code.

MR. BRIDGMAN: What has just been said leads me to ask: do these provisions such as this one and numerous others that are in this act that relate to merchants, relate to farmers? Is the farmer a merchant?

MR. LLEWELLYN: Not under the definition of the act.

MR. BRIDGMAN: You are quite sure that that would be construed as excluding farmers, so we wouldn't have to have farmers associations backing this to get through these special merchant provisions.

MR. LLEWELLYN: No. Transactions between merchants are inside the mercantile area with a merchant on each end.

MR. HOWARD: Some years ago, in our state, there was legislation and an act was presented by which the court was allowed to select an impartial expert who was to testify as a witness with knowledge on the part of the jury that he was chosen by the court. That procedure might be adapted to this [p. 137] case and would avoid the constitutional objection. The only trouble I see with it reminds me of what Mr. Schnader said because we couldn't get it passed.

MR. HARNO: That is the Expert Testimony Act, Mr. Chairman.

MR. LANE: I think that the Commissioner from New York is a very forward looking writer of statutes. It is a consummation devoutly to be wished to get these commercial cases tried expeditiously. Ever since the time of Shakespeare, we have had complaints of the law's delay, but even with that, we must stay within certain settled principles of law, certain landmarks we call them. The jury system is so fastened upon all our state constitutions that I think it would be impossible to amend those constitutions within ten years or maybe more, even if we had an agreement among merchants as to this procedure. Now I remember last year or the last session of our Legislature, we went before it with our Expert Witness Act, with experts to be appointed by the courts, and it was very, very bitterly fought, and we had a very hard time to pass that bill in the Legislature.

We have our Arbitration Act which the merchants can now resort to and we have in our state now the Expert Witness Act. If this could be changed or modified so that these experts could come into court and be cross-examined, I think in our state it might be constitutional, but we are up against the proposition also in Wyoming that an Act can only cover one subject. Here it would cover a subject of procedure and a subject of substantive law. There are a great many things that are very worthy but as practical lawyers we cannot set aside the Constitution and we cannot coerce the Legislature to pass laws. If we do, we are violating our oath. We cannot come to the Legislature under our oath and say, "Pass this law whether it is constitutional or not." We must give them a definite statement if they call us into a committee hearing. If we think that the law is unconstitutional we should tell them that. I do not think that we can infringe upon the province of the jury. In our state it provides that questions of fact should be decided by the jury. I know if we can get this modified so that it will expedite the hearing of our cases, and God knows we are all suffering from that, it will be a wonderful work on the part of our reporter or the writer

of this statute. But under the circumstances, I think that this could be recommitted with the suggestion that our able reporter give it attention during the coming year, and he might be able by the next meeting of the conference to bring in something that will expedite court procedure along these lines and which would not infringe upon the right of the jury to pass upon the facts or upon other constitution violations which have been mentioned here, such as the due process which we all have, both in the Federal Constitution and in our state constitutions as far as I know.

[p. 138]

MR. ROWLAND: What is the argument against the cross-examination?

MR. LLEWELLYN: When the experts come into court?

MR. ROWLAND: Yes, a lot has been said here about cross-examination and violation of constitutional provisions, but what would be the argument against permitting or allowing cross-examination of these expert witnesses before the jury?

MR. LLEWELLYN: I have been thinking about that as the discussion went on. The reason why this provision was in initially was because the experts were felt in their deliberations to be in the nature of a tribunal rather than in the nature of witnesses. Secondly, because it was desired so far as possible to keep the effect of what they had to say clean and simple, so that it would make its dent and stand out in the minds of a jury, because there it sat, uncomplicated, in simple, written form. I had not, at that time, nor had anybody until today thought of this trouble about cross-examination in relation to constitutionality, nor had it been raised previously in any discussions with me.

I am very far from satisfied about the points of constitutionality which have been made, that is the points of supposed unconstitutionality. I should hate to have the meeting close on the motion that these gruesome fears about interference with the noble trial by jury have any

such constitutional bearing as were suggested by those who have the fears. But I don't see that this is either the time or the place to argue that because I think Mr. Rowland comes closer to the matter—why can't the privilege of cross-examination be put in if, at the time of the trial, either side wishes to challenge the experts?

Moving to another point raised especially by Mr. Thomas, though the experts will be moving largely upon the basis of their own knowledge and should, still before they reach their determination, counsel for both sides have had a chance to present the facts and argue to them; I do not see this terrible danger of their being misled, they being reasonable men, they can see a point when they hear it, into the creation of usage which is non-existent, because counsel has been there to make them do some thinking.

Finally, and on the general theory of unconstitutionality—leaving Mr. Schnader's point, which is one that I feel to have a real punch, for last—the notion that to invade the province of the jury by somewhat modifying the traditional manner of jury trial is therefore to become unconstitutional, because the trial by jury provision sits in the constitution, that feeling is a feeling which rests on a total ignoring of what has been done in the way of modifying the historic jury trial and [p. 139] what is going to continue being done and continue to get by the courts. But the two problems of constitutionality are to be sharply severed. The one is: Are you up against your jury trial provision of your due process clause? That, we can speak of as the general constitutional question because that you have to wrestle with whether this goes into a separate act or whether it sits in this act. It cuts through the whole question of whether it is doable without constitutional amendment.

The special constitutional question is that raised by Mr. Schnader—put any such provision or set of provisions into a sales act and do you not run up against the one subject: constitutional clauses? On that the path of wisdom is the path of caution. There is no need to run up against that. You can bring in a companion act to run with the sales act, covering any material of this character, and it



seems to me to be quite necessary that that be done because you don't know what the decision would be.

On the other, I think that part of the job of your committee for next year is not only to rework the lines of the section but to provide you in its report with something of the brief for the constitutionality of whatever lines are hit upon, with some of the authorities which make that brief a perfect persuasive, because neither the vague fears of my brethren who are worried about constitutionality, nor the light assurances on my part that it is really all right, are worth a hoot. What we need is to get down to the cases and see where we are at. It has been a highly illuminating discussion, however, gentlemen. I think it is fair to state that the discussion of this section closing this evening's meeting has been, by all odds, the most illuminating discussion on the Sales Act we have had, and from the standpoint of the Committee, thanks and more thanks! We got light, lots of light.

Mr. Chairman, we are not going to have a chance to report back, but we are under a duty to stop at ten o'clock, as I understand the Chairman.

By unanimous consent, is there any objection to extending this discussion for two minutes?

MR. THOMAS: It isn't a discussion. I just want to suggest this to the Commissioners and to Mr. Llewellyn as draftsman, there is provision in here for judicial review of the findings of the merchant experts—

MR. LLEWELLYN: No, No! Judicial review of the rulings of the court at the hearings of the merchant experts.

MR. THOMAS: Oh! Well, you would have that anyhow, wouldn't you?

[p. 140]

MR. LLEWELLYN: There is a provision in here relaxing the rules on evidence, and those rulings have got to be subject to review.

MR. THOMAS: You would have to relax the rules of evidence to get the findings in.

MR. LLEWELLYN: This is the hearing at which the merchants make their findings. That isn't the hearing

at which the merchants' results are handed to a jury. It isn't the jury trial.

MR. THOMAS: I take that when the case is all in, they go off by themselves and make up their findings, and they can make and hand those to the jury, but I got the impression that there was a provision for the review of the findings. I don't see how that is possible.

MR. LLEWELLYN: Mr. Thomas, you don't visualize this as it is planned. I do not know whether the sections are at fault.

MR. THOMAS: I am probably wrong.

MR. LLEWELLYN: The picture set here is that a hearing occurs before the merchant experts with the court sitting and presiding; no jury.

MR. THOMAS: I didn't understand that.

MR. LLEWELLYN: That is supposed to occur and be complete before you ever get to any jury trial at all. That is the picture that is set up here.

MR. LANE: You say here, Mr. Llewellyn, "but the finding can be disregarded by the jury if they can in conscience disregard it." If they don't believe this as a fact, they are going to disregard it. Why do we need that at all? That is an inherent power of the jury, to disregard any evidence if they don't believe it.

MR. LAWOTHER: A point of order, Mr. Chairman, it is ten o'clock. I want to go to bed!

CHAIRMAN VAN WINKLE: I think that is a good point. Mr. Llewellyn, I will entertain a motion to take a recess until nine-thirty, tomorrow morning.

MR. LLEWELLYN: The motion is made.

[The motion was seconded, put to a vote and carried.]

## APPENDIX E\*

COMMENT ON SECTION 5-8 (S77)  
CURE OF IMPROPER TENDER OR DELIVERY;  
REPLACEMENT

The present section follows the general policy of this Act of preserving the substance of the parties' agreement and avoiding an upset of the deal by technical matters which can be handled without undue hardship to either party by correction of the defect or by money allowance. This section looks to assuring the buyer of a tender of the full substance to which he is entitled under the contract, while preventing him from escaping from his own contractual obligation by a *surprise* rejection of a shipment which the seller had good reason to believe would be acceptable. Subsection (2) seeks to avoid the freezing of a seller's breach by the buyer's rejection of any defective tender made before the time for delivery under the contract has expired. The rules of this section may be altered by agreement of the parties to the contrary.

\* \* \*

1. *Subsection (1)*. Ordinarily in sales contracts between merchants the normal course of business involves the acceptance of deliveries which depart somewhat from the strict contractual obligations of the seller. Discrepancies in shipments are commonly waived altogether or are adjusted by money allowances. This common practice has lead to an extra-legal but very real reliance by sellers that buyers will accept what is legally a defective tender although in substance it conforms to the contract. In "good" times buyers are usually eager to accept goods which are "moving" despite minor variations from the contract and therefore "surprise" insistence on technical rights when the market has suddenly failed produces injustice and hardship.

The courts in the past have used several lines of reasoning in attempting [p. 2] to protect the seller who thus relies on the acceptability of his shipment. They have in many instances construed the terms of the agreement in their commercial, rather than their literal, sense. This Act, of course, is entirely in accord with this type of construction and has adopted a policy of full incorporation

---

\* Llewellyn Papers, file J(X)(2)(f).

of usage of trade and course of dealing into the interpretation of the agreement. [See Section 1-12 (S 9) defining "agreement," and Section 2-8 (S 26) on good faith and commercial standards.] However, this line of reasoning is not adequate to meet many of the situations which arise. Secondly, many courts in an attempt to foreclose buyers who reject in commercial bad faith, have applied a rigorous rule that a buyer waives all defects which he does not state at the time of rejection. This rule in general application has proved to work severe hardships on buyers who have rejected in good faith and for substantial cause. [Compare Section 7-5 (S 94) on waiver of buyer's objection by failure to particularize, and Comment.]

Finally, many courts have moved within the exceedingly indefinite common law concept as to when a faulty tender followed by rejection "freezes" a breach and have allowed ample room for curative tenders wherever possible. In general this is the policy adopted by the present section, and this Act approves the results of such cases as *Hudson v. Germain Fruit Co.* (1891) 95 Ala. 621; 10 So. 920, where a carrier refused to permit inspection by the buyer before acceptance because the bill of lading did not so provide. The buyer refused to accept the goods although he was offered an opportunity to inspect the next day and the seller recovered the purchase price.\*

[p. 3] The basic purpose of this subsection is the avoidance of injustice to the seller by reason of the surprise rejection by the buyer. However, the seller is not protected unless he had "reason to believe" that the tender would be acceptable. He is charged

---

\* See also *Stock v. Snell* (1922) 240 Mass. 427; 134 NE 378 (pastry flour not ordered was included in shipment and upon the buyer's rejection the seller "eliminated" flour and ordered the draft reduced accordingly; the seller recovered the purchase price upon the buyer's continued rejection); *Forsyth Furniture Lines v. Druckman* (1925, CCA 4) 8 F (2d) 212 (seller shipped two carloads of furniture in one month under contract calling for one shipment per month and the buyer refused to pay for all of the goods which had been shipped under the contract; seller recovered purchase price with money allowance to the buyer for any loss caused by premature shipment); *Mutual Chemical Co. v. Marden, Orth & Hastings Co.* (1923) 235 NY 145; 139 NE 221 (where the seller gave notice of readiness to ship a carload well in advance but the buyer delayed sending shipping instructions until the last day for delivery saying he would accept the bill of lading the next day; the shipment being slightly in excess of the contract amount, the buyer rejected and the seller, within three days, offered to include excess goods at the original contract price; seller recovered purchase price since cure of tender was timely under the circumstances).

with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract. Thus no element of surprise is involved in overseas documentary contract, for instance, where the common practices of documentary resale, marine insurance, and letter of credit financing have set a pattern of rigid compliance with contract terms known in the older law as the "strickness" of mercantile contracts. Moreover, modern usage of trade has introduced little or no relaxation in those terms which are required to be evidenced by the documents except in regard to commercially reasonable variations of quantity. Similarly, in the case of some goods such as precision parts or chemicals destined for gas mask manufacture, it is recognized by all merchants that quality is vital and no variation is permissible. In other transactions time may be of the essence, as in the case of a shipment of turkeys for the Thanksgiving market.

If the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the inclusion [p. 4] of a "no replacement" clause in the contract, the seller, of course, will be held to rigid compliance. But in a "form" contract a printed clause to this effect will not bar the seller's rights in any transaction where it is out of line with trade usage or the prior course of dealing unless it is clear that the seller's attention has really been directed to it. [See Comment to Section 2-9 (S 23) on unconscionable contract or clause, and General Comment to II and III.]

2. "*A further reasonable time to substitute a conforming tender.*" These are intended as words of limitation to protect the buyer. In some cases there will be no "reasonable" time for the seller to make a cure and he will be forced to stand by his original tender. This will be true particularly if the market season for the goods is nearly ended, where remanufacture is a lengthy process and will consume undue time, or where transportation time is long and the defect is discovered only after the arrival of the goods. And where a contract calls for a "May" overseas shipment, the correcting tender must be shipped in May. If the seller cannot make such a shipment available, Subsection (1) will not help him. [Compare *Bowes v. Sand* (1877 H.L.) 2 App. Cas. 455, where a contract calling for March and/or April shipment of rice was held breached by partially loading the vessel in February.\*\*] However, the ever growing usage

---

\*\* This Act, however, does not approve the doctrine of this case that a

of trade which substitutes price adjustment for rejection when the shipments fall within commercially reasonable limits of variation will, under this Act, solve many such difficulties without recourse to this particular subsection. [See Section 1-12 (S 9) on meaning of agreement, Section 2-11 (S 21) on course of dealing and usage of trade, Sections 8-19 (S 121) and 8-20 (S 122) on contractual modification of remedy.]

---

February "shipment" results when loading is begun in February and completed in March.

## APPENDIX F\*

COMMENT ON SECTION 7-9 (S101)  
BREACH IN INSTALLMENT CONTRACTS

In general the present section follows the Original Act, Section 45 (2) and the more commercial case law thereunder. However, this Act makes explicit the more mercantile interpretation of many of the rules involved. Thus the definition of an installment contract is phrased more broadly in this section than in the Original Act, so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party. The practical commercial understanding of such clauses as "each delivery is a separate contract" is also incorporated in Subsection (1), which makes clear that such contracts nonetheless call for installment deliveries.

Subsection (2) is designed to further the continuance of the contract in the absence of an overt cancellation. The perplexing question arising when an action is brought as to a single installment only, is resolved by making such action waive the right of cancellation. This of course involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within Section 7-11 (S 99). Whether the non-conformity in any given installment justifies cancellation as to the future depends, not on whether such non-conformity indicates an intent or likelihood that the future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance under Section 7-10 (S 98), but has not an immediate right to cancel the entire contract. It is clear under this Act, however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." The policy of the Original Act is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

[p. 2] Finally, whereas subject to the rules on cure of tender [Section 5-8 (S 77)], a tender under a single delivery contract must comply accurately with the seller's obligation or be subject to

---

\* Lewellyn Papers, file (IX)(2)(f).

rejection, under the present Subsection (3) an installment delivery must be accepted if the non-conformity is curable and the seller gives adequate assurance of cure.

\* \* \*

1. *The meaning of "installments" under this Act.* By including installment deliveries tacitly authorized by the circumstances [Section 3-6 (S 31) on delivery in single or several lots] or by the option of a party [Section 3-10 (S 35) on options and cooperation respecting performance] within the coverage of this section, this Act merely reflects the view of the sound cases. Thus in *Lynn M. Ranger, Inc. v. Gildersleeve* (1927) 106 Conn. 372; 138 Atl. 142, a seller of six carloads of coal consigned to himself was held entitled to recover the price of two carloads diverted to the buyer out of the total called for by the contract; and in *Czarnikow-Rionda Co. v. West Market Grocery Co.* (1927, CCA 2nd) 21 F. 2d 309, where the contract called for shipments at the seller's option during August, the fact that a first lot had been delivered, paid for, and accepted did not bar a rejection of a subsequent defective lot. Similarly in *Portfolio v. Rubin* (1922) 233 NY 439; 135 NE 843, a buyer who had ordered four pieces of textile and rejected two as non-conforming, was held justified in tendering merely the price of the two pieces accepted.

In regard to the apportionment of the price for separate payment it must be remembered that this Act applies the more liberal test of what *can* be apportioned rather than the test of what is clearly apportioned by the agreement. [See Comment on Section 7-7 (1) (S 96) on acceptance at the "contract rate;" and Section 3-6 (S 31) on delivery in single or several lots.] This Act also recognizes [p. 3] approximate calculation or apportionment of price subject to subsequent adjustment as in Section 3-20 (1) (S 45) on "net landed weights" and the like. Nevertheless, it is rare that a contract will imply that separate payments are to be made for each lot delivered, unless the price is at least roughly calculable by units of quantity. Where installments are authorized, however, no generalized contract between wholly "entire" and wholly "divisible" contracts has any standing under the sound cases or under this Act, which undertakes at all times to focus issues in terms of the sense of the situation. The court's statement in the *Czarnikow-Rionda* case, discussed immediately above, that although a contract may be "treated as an entire contract when the issue is whether a failure by the seller or the buyer in respect to an early installment may be so material a breach of the contract as to justify the other



party in refusing to perform in respect to later installments . . . it does not necessarily follow that the contract is to be deemed entire when the issue is whether acceptance of an early installment precludes rejection of a later defective installment," holds equally in regard to whether a first lot requires separate acceptance and payment.

2. *"Each delivery is a separate contract" and similar clauses.* This type of clause with its many variations, represents the commercial seller's attempt to avoid the old rules that, unless otherwise agreed, delivery does not require acceptance unless made in a single lot, and that delivery of the contract quantity must be complete before any payment is earned. This Act, however, rejects any approach which gives such clauses their legalistically literal effect.

Even where a clause speaks of "a separate contract for all purposes" [p. 4] a commercial reading of the language under Section 2-8 (S 26-2) on good faith and commercial standards, requires that the singleness of the document and the negotiation, together with the sense of the situation, prevail over any uncommercial and legalistic interpretation of a form clause whose possible unfortunate import is not clearly understood either by commercial men or by lawyers. "Each delivery or shipment shall be treated as a separate contract, and the failure to give or to take any delivery or shipment shall not cancel the contract as to future deliveries or shipments" . . . is a clause which is often found in contracts of this description and which is very difficult to construe, or at least to apply to all possible emergencies. It seems to me, however, that whatever effect it may have . . . it cannot be construed so as to defeat the rights of the buyer under s. 31 of the Sale of Goods Act."\* [Robert A. Munro & Co. Ltd. v. Meyer (1930) 2 K.B. 312, 332.]

There is commercial sense in reading such a "separate contract" clause as requiring a buyer to pay for a second and adequate delivery despite a pending claim for adjustment or damages due to a first defective delivery. Even without such a clause there is also commercial sense in requiring a seller to make his second delivery despite the buyer's holdout on payment for the first because of a good faith claim for adjustment. [See Section 8-16 (S 118) on deduction of damages from price; also Comment on Section 7-10 (S 98) on right to adequate assurances, and *Lander v. Samuel*

---

\* Section 31 of the Sale of Goods Act corresponds to the present section.

Heller Leather Co. (1943) 314 Mass. 592; 50 NE (2d) 962, there discussed.] It is commercially reasonable in the case of a single installment, and especially in view of the "cover" provisions of this Act. [Section 8-11 (S 113)], to give such clause with its specific non-cancellation provision, [p. 5] the effect of requiring the buyer to cover by buying elsewhere in the event of the seller's non-delivery or misdelivery. But to press such a construction to the point of forcing the buyer to cover a sequence of non-deliveries as was done in *Higgin v. Pumpherston Oil Co., Ltd.* (1893) 20 Session Cases 532, is inconsistent with this Act. The security and assurance provisions contained in Section 7-10 (S 98) embody policies and measures which make it impossible, whatever the language of the agreement, to disregard the essential commercial nature of a standing relation embodied in a single document and the right to cancel when this relation has been unduly disrupted. [See also Section 8-20 (S 122) barring a limitation of remedy which defeats the essential purpose of the contract.] Thus this Act rejects the broad ruling in such cases as *Hettrick Mfg. Co. v. Waxahachie Cotton Mills* (1924, CCA 6th) 1 F. 2d 913, in which a non-cancellation clause in a contract calling for forty separate deliveries was held to result in forty separate contracts, giving the buyer no right of cancellation regardless of how many defective deliveries were made by the seller. Indeed the aggrieved party's rights are also safeguarded by his right to assurances under Section 7-10 (S 98), where the breach in prior installments, though not yet substantial enough to impair the value of the whole contract under this section, threatens to do so.

3. *Substantial impairment of the value of the whole contract under Subsection (2).* This test of the right of the aggrieved party to cancel the unperformed balance of the contract is unfamiliar in phrasing, though it is analogous to the familiar concepts of substantial or essential breach as contracted with "severable" breaches. This is the same language used in Section 7-1 (S 99) as to repudiation which justifies a cancellation. The reason for adopting this test lies in the distinction made by this Act between the more jeopardizing of security in regard to future performance, [p. 6] for which Section 7-10 (S 98) provides relief by allowing suspension of performance and demand for assurance, and that flat repudiation which justifies immediate cancellation and suit for damages. Once this distinction has been made, the only type of defect in an installment which justifies summary cancellation is one whose immediate effect is a substantial impairment of the value of the whole, which is the

sound result also whenever there is breach of one of a collection of disparate obligations gathered into a single contract. Lesser breaches which entail insecurity have their remedy under Section 7-10 (S 98), over and above the remedies which relate to the deficiency in the installment as such.

In regard to default in payment it has been well said: "We must know the cause of the default, the length of the delay, the needs of the vendor, and the expectations of the vendee. If the default is the result of accident or misfortune, if there is a reasonable assurance that it will be promptly repaired, and if immediate payment is not necessary to enable the vendor to proceed with performance, there may be one conclusion. If the breach is willful, there is no just ground to look for prompt reparation, if the delay has been substantial, or if the needs of the vendor are urgent so that continued performance is imperiled in these, and in other circumstances, there may be another conclusion." [Cardozo, J. in *Helgar Corp. v. Warner's Features Inc.* (1918) 222 NY 449; 119 NE 113.] Such lines of analysis this Act approves and adopts whether in regard to the buyer's default in payment or acceptance, or the seller's default in delivery, but the question turns not on the confused issue of the Original Act: "whether the breach is so material as to justify the injured party in refusing to proceed *and* suing for damages for breach of the entire contract," but on the narrower issue of whether the value of the whole unperformed contract is so substantially impaired by the breach as to warrant [p. 7] cancellation and damages. A much lesser impairment, if it gives insecurity as to the contract-breaker's future adequate performance, will justify "refusing" temporarily "to proceed," pending the result of a demand for assurance.

This does not mean, however, a reversion to "the rule of the English statute . . . which keeps the contract alive unless the breach is equivalent to repudiation" (Cardozo, J. in the *Helgar* case, *supra*) if "equivalent to repudiation" describes such breach in installments as indicates an *intention* not to perform. The question under this Act goes not to intention as to the future, but to the degree of injury actually suffered by the default. If that injury is sufficient, it happens that the *legal consequences* are almost the same as those entailed by a repudiation.

4. *Seasonable notice of cancellation under Subsection (2).* A buyer who accepts a non-conforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a

response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for giving notice of cancellation, judged by commercial standards under Section 2-8 (S 26), extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

5. *Subsection (3) (a); When an installment is rejectable.* Installment contracts of necessity involve some degree of standing relations, with the result that the test of accurate conformity (subject to the factors of [p. 8] construction discussed in the General Comment to Parts II and III) which is applicable to a single total delivery under Section 7-1 (S 90) on buyer's rights on improper delivery, is here displaced in favor of a more commercial doctrine. This does not mean that an installment agreement cannot require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. Thus in a contract for precision parts, chemicals for delicate use, or quality merchandise for a quality house, the circumstances may give notice that even minor non-conformity substantially impairs the value for the purposes of the contract. Hence what the present subsection means for installment contracts is that in the absence of circumstances which challenge attention to the need for exactitude, a clause requiring accurate compliance as a condition to the right to acceptance must have some basis in reason, must avoid imposing hardship by surprise (see General Comment to Parts II and III, paragraphs 6, 7, 8, 9 on avoidance of surprise) and is readily subject to waiver or to displacement by practical construction under Sections 2-12 and 2-13 (S. 22 and S. 24).

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. In ordinary circumstances the simplest defect to cure is one of quantity and non-conformity of this type will not normally constitute a substantial impairment of value. But an excessive shipment which swamps the buyer's storage facilities or an undershipment

which fails to meet his needs would be rejectable if acceptance [p. 9] of the whole overshipment in the one case was insisted on by the seller or if no immediate assurance a speedy supplement was forthcoming in the other.

The facts of *Ballantine and Co. v. Cramp & Bosman* (1923, K.B.D.), 129 L.T.R. 502, present a good illustration of the assortment problem in installment contracts insofar as the factor of "evenness" as an attribute of merchantability under Section 3-13 (S 83), is involved. In that case the contract was for 2500 sheep carcasses weighing under 72 lbs., the average weight not to exceed 60 lbs. The first shipment averaged 62 lbs. and the seller tendered five bills of lading, as a single tender, two of which covered carcasses averaging less than 60 lbs. The buyer rejected the entire shipment. The second shipment averaged 54 lbs. and was accepted. Under this Act the rightfulness of the buyer's rejection depends first, on the possibility of cure and secondly, on the adequacy of assurance of the cure. But in any event, contrary to the indication in the *Ballantine* case, the seller would be permitted to retender immediately and demand acceptance of the two bills of lading which covered goods which fitted the contract description since no quantities had been fixed for the installments. [Section 5-8 (S 77) on cure of improper tender of delivery.]

The defect in required documents referred to in Subsection (3) (a) refers to such matters as the absence of insurance documents under a c.i.f. contract, falsity of a bill of lading, or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable. As between the buyer and the seller, however, when the defect shown by the documents is a defect in the goods, such as a shortage in quantity, it is not within the documentary exception of Subsection (3) (a). In such a case the test is that of substantial impairment of the value of the installment.

[p. 10] 6. *Cure of non-conformity of an installment* in the first instance, can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. As contrasted with the less commercial cases, this Act requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an overshipment by severing out an acceptable percentage thereof. [Compare General Comment to Parts II and III, paragraph

11, on the pattern of acceptance with adjustment; and Section 2-8 (S 26) on good faith and commercial standards.] Thus this Act approves such holdings as in *Stock v. Snell* (1922) 240 Mass. 427; 134 NE 378, in which the buyer rejected a shipment which included pastry flour not ordered by him in addition to the contract goods. The seller "eliminated" the unordered flour from the draft for the price and was held entitled to recover upon the buyer's continued rejection of the shipment.

The facts of *Burrows & Kenyon, Inc. v. Warren* (1925, CCA 1) 9 F. (2d) 1, although not involving an installment contract, present an instance of the type of cooperation expected from the buyer under this Act. In that case a cargo of lumber arrived at the buyer's dock in sizes at great variance with the contract. The market had dropped. The seller offered to sort out the appropriate lumber and to supply any deficiency from local stocks. Nothing appeared to show the materiality of the short delay thus involved. Under this Act the minor extra expense incurred by the buyer through having surveyors and labor at the dock to sort the lumber is plainly curable by allowance on the price; the only question would be whether the obstruction of the dock would amount to an unreasonable burden. If it would not, the seller's proposed cure would be in order. Similarly, on the facts of [p. 11] *Jackson v. Rotax Motor & Cycle Co.* (1910, C.A.) 2 K.B. 937, where part of a shipment of motor horns arrived in London in a damaged condition, but the dents were such as could be straightened and the necessary repolishing done by relatively simple and inexpensive processes. Under this Act the question would turn not on accurate conformity of the delivery as it did in that case, but on whether an unreasonable burden of trouble and delay would be involved in refinishing, as it might well be, for instance, by disrupting a production schedule. But plainly, under Paragraph (3) (b), it is the seller who must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation, to paying a minor excess of freight, or to separating a certain number of casks from a larger bulk. He is not required to engage in even minor manufacturing operations on goods agreed to be delivered in merchantable condition unless the circumstances indicate that such touching up would be simple for the buyer. (For example, a delivery of parts to a manufacturer for further manufacture where no dislocation of the buyer's production schedule would be involved and the cost of rework would be minor.) Also, if the course of the buyer's performance on previous installments had been to rework,

timely notice of strict conformity would be necessary to permit rejection at all. [Section 2-12 (S 22) on course of performance or practical construction.] Adequate assurance for purposes of this subsection is measured by the same standards as under Section 7-10 (S 98), on right to adequate assurance of performance. (See Comment thereon.)