

# Widener University Delaware Law School

---

From the Selected Works of John D Wladis

---

1991

## General Provisions, Sales, Bulk Transfers, and Documents of Title

John D Wladis  
David Frisch



Available at: [https://works.bepress.com/john\\_wladis/9/](https://works.bepress.com/john_wladis/9/)

# General Provisions, Sales, Bulk Transfers, and Documents of Title

*By David Frisch\* and John D. Wladis\*\**

This survey reviews recent case law and related developments under articles 1, 2, 6, and 7 of the Uniform Commercial Code ("U.C.C." or "Code").

## ***INTERACTION OF TORT AND CONTRACT***

Courts continue to endorse the economic loss doctrine in commercial disputes. Under that doctrine a commercial buyer is permitted to sue the seller or manufacturer of defective goods only in contract and not in tort if the loss the buyer suffered is purely economic. If the buyer suffers personal injury or property damage to property other than the goods sold the economic loss doctrine does not apply and the buyer can sue in tort as well as contract.

In *Chemtrol Adhesives, Inc. v. American Manufacturers Mutual Ins. Co.*,<sup>1</sup> the Ohio Supreme Court applied the economic loss doctrine to bar suit in tort by a commercial buyer against its seller where the buyer suffered economic loss and property damage to the goods themselves. There the seller designed and constructed an arch dryer used to evaporate moisture from solvents used by the buyer. The dryer failed to work properly causing damage to components of the dryer. The buyer sued in both contract and tort for repair costs and consequential damages, primarily extra expenses incurred during the times the dryer was not functioning.<sup>2</sup> The trial court granted summary judgment for the seller on all theories. On appeal the Ohio Supreme Court affirmed as to the tort claims but

\*Mr. Frisch is a member of the Florida and Rhode Island Bars and a professor of law at the Widener University School of Law.

\*\*Mr. Wladis is a member of the New York Bar and an associate professor of law at the Widener University School of Law.

The following people contributed to the preparation of this article: D. Benjamin Beard, C. Leo Cook, Scott Cousins, Rudolphe J. A. deSeife, Donald W. Garland, Donald R. Hobbs, Thomas Holdych, Janet L. Richards, Diane Modes, Mark E. Roszkowski, William R. Waddell, William F. Young.

1. 42 Ohio St. 3d 40, 537 N.E.2d 624, 9 U.C.C. Rep. Serv. 2d 88 (1989).

2. This suit was initiated by the buyer against its insurers for refusal to provide insurance benefits. The insurers, as subrogees of the buyer's claims against the seller, filed third party claims against the seller. The court's opinion concerns these third party claims.

reversed and remanded as to the contract claims.<sup>3</sup> The tort claims were in negligence and strict liability in tort. As to these claims the court ruled that damage only to the goods themselves was covered by the economic loss doctrine so that the buyer could not sue the seller in tort for this damage or the related consequential damages.<sup>4</sup> Of interest is the fact that the court adopted the risk of physical damage test approved by the Third Circuit in *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*<sup>5</sup> Under that test if the defect creates an unreasonable risk of personal injury or property damage the economic loss doctrine will not apply even though only the goods sold are damaged. However, it found the defect not to raise such a risk in this case.

In *Board of Education of City of Chicago v. A.C. & S., Inc.*<sup>6</sup> the Illinois Supreme Court held that for the purpose of the economic loss doctrine contamination of the plaintiff Board of Education's school buildings with asbestos particles from asbestos products supplied by defendants was property damage to property other than the goods sold, so that the Board of Education could maintain negligence and strict liability in tort claims against the suppliers of the asbestos. In so doing the court rejected the risk of physical injury test adopted by the Ohio Supreme Court case in *Chemtrol Adhesives*. The Illinois court ruled that what was required to recover in tort was a showing of actual personal injury or property damage to property other than the goods sold and not merely a defect creating the risk of such injury or damage. The court also cautioned that asbestos cases were "unique"; it admonished readers of the opinion that "the holding in this case should not be construed as an invitation to bring economic loss contract actions within the sphere of tort law through the use of some fictional property damage."<sup>7</sup>

In *Lloyd Wood Coal Co. v. Clark Equipment Co.*<sup>8</sup> the Alabama Supreme Court adopted the economic loss doctrine in a case involving the commercial lease of a front-end loader. The loader suffered substantial fire damage caused by a ruptured hydraulic hose. The lessee's insurance company reimbursed it for the loss and apparently brought this suit to recover what it had paid. The court, concluding that this was a claim for property damage only to the goods leased, applied the economic loss doctrine and barred various tort claims. Several months later the Alabama Supreme Court extended the economic loss doctrine to a sale of a motor vehicle.<sup>9</sup>

3. The court held it to be a question of fact whether timely notice of claim had been given under U.C.C. section 2-607(3)(a). This aspect of the court's opinion is discussed *infra* text at notes 129-31.

4. See also *Northrup King Co. v. Ammons*, 9 U.C.C. Rep. Serv. 2d 836 (4th Cir. 1989) (applying North Carolina law) (Sale of seed to farmers. Crops failed because seed contaminated with bacterial rust. Negligence claim dismissed. Court opined that North Carolina would apply economic loss doctrine.).

5. 652 F.2d 1165, 33 U.C.C. Rep. Serv. 521 (3d Cir. 1981).

6. 131 Ill. 2d 428, 546 N.E.2d 580, 10 U.C.C. Rep. Serv. 2d 90 (1989).

7. 131 Ill. 2d at 445, 546 N.E.2d at 588, 10 U.C.C. Rep. Serv. 2d at 97.

8. 543 So. 2d 671, 9 U.C.C. Rep. Serv. 2d 899 (Ala. 1989).

9. See *Dairyland Ins. Co. v. General Motors Corp.*, 549 So. 2d 44, 9 U.C.C. Rep. Serv. 2d 903 (Ala. 1989) discussed *infra* text at notes 82-87.

In *Miller v. United States Steel Corp.*<sup>10</sup> the Seventh Circuit, applying Wisconsin law, applied the economic loss doctrine in a suit by a building owner against the manufacturer of steel sold to a subcontractor who fabricated it into steel panels that were then installed in the building. The owner sued in tort for the cost of replacing the panels. The Seventh Circuit noted that the Wisconsin Supreme Court previously had adopted the economic loss doctrine in a case in which there was privity of contract between the parties.<sup>11</sup> It then opined that the same court would apply that doctrine even when the parties were not in privity. The building owner argued that the economic loss doctrine was inapplicable because water damage to the building caused by the defective panels was property damage to property other than the goods themselves. The court rejected this argument for two reasons: first the water damage was incidental;<sup>12</sup> second the building owner did not sue for that damage.

## STATUTE OF FRAUDS

Although the sufficiency of a writing under U.C.C. section 2-201 does not explicitly depend on the inclusion of any particular term, the contract is not enforceable beyond the quantity of goods “shown in such writing,”<sup>13</sup> or “admitted,”<sup>14</sup> or “which have been received and accepted.”<sup>15</sup> Several cases decided this past year provide interesting examples of the impact of this requirement and underscore the need to seriously consider whether all references to quantity now contained in section 2-201 should be deleted if the statute survives any future revision of article 2.<sup>16</sup>

10. 902 F.2d 573, 11 U.C.C. Rep. Serv. 2d 1131 (7th Cir. 1990).

11. *See Sunnyslope Grading Inc. v. Miller, Bradford & Risberg, Inc.*, 148 Wis. 2d 910, 437 N.W.2d 213, 8 U.C.C. Rep. Serv. 2d 652 (1989).

12. *See Chicago Heights Venture v. Dynamit Nobel of America, Inc.*, 782 F.2d 723, 726–29 (7th Cir. 1986).

13. U.C.C. § 2-201(1).

14. U.C.C. § 2-201(3)(b).

15. U.C.C. § 2-201(3)(c).

16. The Study Group appointed by the American Law Institute/Permanent Editorial Board to study article 2 has recommended in its Preliminary Report that if section 2-201 is not repealed, all references to quantity should be deleted. In its opinion, “[t]he effect of this requirement has been to induce courts to strain to find some quantity term to interpret and, in addition, to undercut the basic ‘gap filling’ policies of Article 2, Part 3 without any evidence that fraud has been deterred or that the fact finding process was impaired.” Rec. A2.2 (2)(b).

At least one member of the subcommittee feels that the quantity provisions of section 2-201 should not be eliminated. It is argued that the quantity term is 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. The quantity term places a limit on the size of the contract, and therefore the size of any fraudulently asserted contract. Preliminary Report, Permanent Editorial Board of U.C.C. and A.L.I. and N.C.C.U.S.L., Article 2 Study Group, Part 2, *Amendment of the Statute of Frauds*, Rec. A2.2(A), 5, 6 (Mar. 1, 1990).

Illustrating the potential of a quantity requirement to undercut other substantive provisions of article 2 is *Jo-Ann, Inc. v. Alfin Fragrances, Inc.*,<sup>17</sup> in which the district court granted summary judgment to the plaintiff-buyer, Jo-Ann. The only writing that in any way evidenced the quantity of goods involved was a telex sent by the defendant, stating, "our understanding is that you will be the exclusive distributor for the domestic market in Iceland." Following the lead of those courts which have concluded that the Code does not require the statement of a definite quantity in a requirements contract,<sup>18</sup> the court reasoned that practical considerations compel the same commercially-minded approach to distributorship contracts.<sup>19</sup> Because it would not be feasible to specify an exact quantity, the court concluded that the parties' statutory duty to use their "best efforts" would serve as a substitute by which to assess the limit of enforceability.<sup>20</sup>

Similarly, in *Zayre Corp. v. S.M. & R. Co., Inc.*,<sup>21</sup> the plaintiff-seller argued that the absence of a definite quantity term was not fatal to its case because the contract was a requirements contract. Unfortunately for the plaintiff, the case serves as an illustration of how not to proceed under the statute. On appeal, following the entry of summary judgment for the defendant, the plaintiff for the first time unleashed a barrage of arguments. For example, the lower court had held that an essential element of a requirements contract is a commitment by the buyer to purchase exclusively from the seller, and that such a promise was lacking in the writings (two letters) produced by the seller. Apparently, the seller never asserted in the lower court the existence of an explicit or implicit agreement on exclusivity nor explained how the two letters established a requirements contract. This failure, said the Seventh Circuit, made it unnecessary to consider the buyer's arguments and explanations on appeal.<sup>22</sup>

17. 731 F. Supp. 149, 11 U.C.C. Rep. Serv. 2d 782 (D.N.J. 1989). For an excellent discussion of this topic, see Bruckel, *The Weed and the Web: § 2-201's Corruption of the U.C.C. Substantive Provisions—The Quantity Problem*, 1983 U. Ill. L. Rev. 811 (1983).

18. See, e.g., *Slocumb Industries, Inc. v. Chelsea Industries*, 36 U.C.C. Rep. Serv. 1543 (E.D. Pa. 1983); *Eastern Dental Corp. v. Issac Masel Co.*, 502 F. Supp. 1354, 30 U.C.C. Rep. Serv. 1217 (E.D. Pa. 1980).

19. It was first necessary for the court to rule that exclusive distributorship contracts are subject to the Code. Although most courts would agree, see, e.g., *Aaron E. Levine & Co. v. Calkcraft Paper Co.*, 429 F. Supp. 1039 (E.D. Mich. 1976); *Cavalier Mobile Homes, Inc. v. Liberty Homes, Inc.*, 53 Md. App. 379, 454 A.2d 367, 35 U.C.C. Rep. Serv. 1081 (1983); *Meuse-Rhine-Ijssel Cattle Breeders of Canada, Ltd. v. Y-Tex Corp.*, 590 P.2d 1306, 26 U.C.C. Rep. Serv. 292 (Wyo. 1979), some would not. See, e.g., *Lorenz Supply Co. v. American Standard, Inc.*, 419 Mich. 610, 358 N.W.2d 845, 39 U.C.C. Rep. Serv. 1169 (1984); *Tile Craft Products Co., Inc. v. Exxon Corp.*, 581 S.W.2d 886 (Mo. App. 1979).

20. See U.C.C. section 2-306(2) ("A lawful agreement . . . for exclusive dealing . . . imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.").

21. 9 U.C.C. Rep. Serv. 2d 465 (7th Cir. 1989).

22. S.M. & R. also argued on appeal for the recognition of a "full-performance" common law exception to the statute which the Illinois appellate court has recognized in the context of U.C.C. section 8-319. This exception provides that if a party has wholly performed, the statute is satisfied if the party has nothing to do but await payment. However, the plaintiff cited no authority; the district

In *Thomas J. Kline, Inc. v. Lorillard, Inc.*,<sup>23</sup> the Fourth Circuit also heard the argument that no specific quantity term was necessary because the contract was a requirements contract. There the letter sent by Lorillard, the defendant, to the plaintiff-buyer said, "We are pleased to inform you that your request to purchase Lorillard products on a direct basis has been approved . . . and you have been added to our direct list of customers for Full Line as successor to [Merrey]," followed by a list of terms. Kline argued that the "direct basis" and "Full Line" language satisfactorily proved a quantity term. As part of the plaintiff's proof that the alleged agreement constituted a requirements contract, the district court allowed parol evidence on the meaning of the disputed terms. The Fourth Circuit held this to be error. Parol evidence is admissible to explain an imprecise statement of quantity, but not to supply the missing quantity term when the contract is silent. The court found the letter to be totally silent as to quantity, because there is no legal or definitional connection between these terms and "amount."<sup>24</sup>

The court's analysis is questionable. Kline believed, based on industry experience and prior dealings with Lorillard, that the reference to "direct basis" meant he could purchase all his requirements on open credit. The jury apparently agreed.<sup>25</sup> The contract's silence results only from the court's refusal to elevate technical jargon and trade usage to the same level of legal relevance as everyday English. No reason for this discrimination is given.

As in past years, there is no shortage of cases involving the merchant's exception to the statute of frauds under U.C.C. section 2-201(2). *American Plastic Equipment, Inc. v. CBS Inc.*<sup>26</sup> shows just how far courts are willing to go to find the requisite merchant status. The Second Circuit was quick to reject the assertion by CBS that it was not a merchant with respect to its sale of plastic toy molds. While CBS might not be a "merchant with respect to goods of that kind,"<sup>27</sup> this definition is too narrow for purposes of U.C.C. section 2-201. To qualify as a merchant, all that is necessary is that one has knowledge of the relevant business practices involved. In this case CBS acquired merchant status based on knowledge which amounted to nothing more than "having sufficient familiarity with the postal system and the answering of mail. . . ."<sup>28</sup>

court mistakenly thought plaintiff was urging application of the U.C.C. section 2-201(3)(c) exception and found S.M. & R. did not meet it. The Seventh Circuit stated that the full performance exception might apply, but since it is similar to U.C.C. section 2-201(3)(c) and promissory estoppel, the district court's mistake was excusable and solely the fault of S.M. & R.

23. 9 U.C.C. Rep. Serv. 2d 61 (4th Cir. 1989).

24. With the observation that "the issue is whether a one sentence letter obligates Lorillard to provide Kline with unlimited credit for its unlimited tobacco requirements." *Id.* at 67, the court suggests its inability to fathom that arrangements of this sort would be reduced to anything less than a multi-page, detail driven document.

25. According to the dissenting judge, the jury's finding demonstrated the sufficiency of the writing. *Id.* at 68 (Sprouse, J., dissenting).

26. 9 U.C.C. Rep. Serv. 2d 848 (2d Cir. 1989).

27. This is the narrow definition of merchant found in U.C.C. section 2-314.

28. 9 U.C.C. Rep. Serv. 2d at 858. *See* Comment 2 to section 2-104 which states that under sections 2-201(2), 2-205, 2-207, and 2-209 "almost every person in business" is a merchant under

*Chambers Steel Engraving Corp. v. Tambrands, Inc.*<sup>29</sup> raises an interesting issue under the specially manufactured goods exception of U.C.C. section 2-201(3)(a), specifically: whether constructing a prototype constitutes a substantial beginning to an alleged oral contract to manufacture additional production machines.<sup>30</sup> The First Circuit agreed with the district court that the exception should be construed narrowly because of the fear of abuse by parties attempting to add additional quantities or other agreements to an established contract. The design and manufacture of the prototype (for which the plaintiff was paid in full), was not enough to constitute a substantial beginning of the alleged oral contract for 20–30 additional machines.

The policy reflected in *Chambers* is the same as that supporting the “part performance” exception of U.C.C. section 2-201(3)(c). Under this provision, partial performance takes the contract out of the statute only to the extent of the part performed. U.C.C. section 2-201(3)(c), like the *Chambers* result, prevents a party from using a small executed contract to support an allegation (possibly fraudulent) that it was merely part of a larger contract. Presumably, this evidentiary bar would be lifted if the references to quantity in U.C.C. section 2-201 are ever deleted.

Finally, the litany of cases involving the effect of reliance on the statute of frauds continues. For those advocating a reliance exception, it was not a very good year.<sup>31</sup> In view of the confusion surrounding this issue, a statutory resolution is needed.

## PAROL EVIDENCE

A signed writing precludes the use of parol evidence to contradict any of its written terms, right? Not quite. The writing must be “intended by the parties as a final expression of their agreement.”<sup>32</sup> Two cases discuss this requirement.

The first case, *Intercorp, Inc. v. Pennzoil Co.*,<sup>33</sup> decided by the Eleventh Circuit and applying Alabama law, concerned a written export distributor sales agreement. The agreement was the culmination of several draft contracts and extensive negotiations. It provided the distributor (Intercorp) with a nonexclusive right to market the supplier’s (Pennzoil) products within a stipulated territory in the Caribbean. Soon thereafter a dispute developed over the distributor’s area. The distributor discovered that the supplier had agreed to permit

section 2-104(1) “since the practices involved in the transaction are nonspecialized business practices such as answering mail.”

29. 10 U.C.C. Rep. Serv. 2d 1152 (1st Cir. 1990).

30. The court held that the question of whether the facts satisfied the exception was a question for the court, not the jury.

31. See *Futch v. James River-Norwalk, Inc.*, 722 F. Supp. 1395, 10 U.C.C. Rep. Serv. 2d 684 (S.D. Miss. 1989) (promissory estoppel not available as an exception to the statute); *International Products & Technologies, Inc. v. Iomega Corp.*, 10 U.C.C. Rep. Serv. 2d 694 (E.D. Pa. 1989) (same); *Hoffmann v. Boone*, 708 F. Supp. 78, 9 U.C.C. Rep. Serv. 2d 474 (S.D.N.Y. 1989) (estoppel principles are inapplicable because plaintiff has not suffered an unconscionable injury).

32. U.C.C. § 2-202.

33. 877 F.2d 1524, 9 U.C.C. Rep. Serv. 2d 454 (11th Cir. 1989).

another company to market the supplier's products on the island of Trinidad, which the distributor believed to be within its territory. Although prior drafts had included that island in the distributor's area, the final agreement did not. The relationship continued to deteriorate until the distributor sued for breach of the distribution agreement. The essence of the distributor's claim was that the supplier had violated the agreement by permitting others to market the supplier's products in the distributor's area, including Trinidad.

The distributor alleged that it had understood the agreement to include Trinidad within its territory. One of the supplier's agents testified that the failure to include Trinidad in the final agreement may have been a typographical error. The distributor also alleged that it had attempted to obtain an exclusive distributorship during the negotiations. It also alleged the supplier had responded that its legal department avoided using the term "exclusive" in its distribution agreements to avoid potential antitrust problems, but that it was the supplier's policy to treat the distribution agreements as exclusive. The supplier conceded that this colloquy had taken place but argued that neither party had intended this policy to be part of the final agreement. The trial judge evidently considered this evidence sufficient to show that the written distributor sales agreement had not been intended by the parties to be a final expression of their agreement. Therefore, it submitted to the jury the distributor's parol evidence as to what the agreement was. The jury returned a general verdict for the distributor on its breach of contract claim.

On appeal, the supplier challenged the trial court's admission of parol evidence. It argued that the trial court misapplied the law by submitting that evidence to the jury without first making a finding that the written distributor sales agreement was not intended to be a final expression. The Eleventh Circuit affirmed, concluding that the trial court implicitly had found the written agreement not to be a final expression and that, therefore, it was proper to submit the parol evidence to the jury.

Though this case permits the use of parol evidence to contradict the terms of an extensively negotiated, signed contract between two commercial entities, it is correct in theory. A writing excludes parol evidence only if the writing is intended by the parties to be a final expression of their agreement.<sup>34</sup> That question is for the court and in ruling on the question, the court considers all of the evidence, including the parol evidence.<sup>35</sup> As a practical matter it will be very difficult to persuade a court that an extensively negotiated, signed contract between two commercial entities does not represent the final expression of their agreement. Consequently, parol evidence usually will be inadmissible to contradict such a contract. However, in this case the party seeking to exclude the parol evidence did not flatly deny its existence. Instead the supplier admitted informing the distributor of its policy to treat its distributorship as exclusive; it also admitted that the exclusion of Trinidad from the written agreement may have

34. U.C.C. § 2-202.

35. 877 F.2d at 1529, 9 U.C.C. Rep. Serv. 2d at 460. *See also* Restatement (Second) Contracts § 209 Comment c (1981).



been a typographical error. These admissions probably were crucial to the trial court's decision to admit the parol evidence.<sup>36</sup>

In the second case, *King v. Fordice*<sup>37</sup> a Texas appellate court permitted the admission of parol evidence to show that an exchange of mailgrams, which on their face appeared to be an offer and acceptance creating a contract for the sale of an airplane, were not so intended by the parties. In a suit by the seller for breach of contract based on the exchange of mailgrams, the buyer alleged that the parties had exchanged the mailgrams solely to enable the seller to get the plane to Dallas for inspection by the buyer. The trial court permitted this evidence to go to the jury, who determined that the exchange of mailgrams did not constitute an agreement. On appeal, the Texas Court of Appeals affirmed the admission of parol evidence. It noted that at common law parol evidence had always been admissible to show that the parties had never intended a writing to be enforceable. The court then concluded that this aspect of the parol evidence rule survived the enactment of the article 2 parol evidence rule (section 2-202).<sup>38</sup>

This result is correct. Section 2-202 seems to have been intended to modify portions of the common law parol evidence rule rather than to displace it entirely. The drafters' primary concern was two-fold.<sup>39</sup> First, to make it clear that the rule does not exclude evidence of commercial meaning supplied by course of dealing, usage of trade, and course of performance;<sup>40</sup> second, to clarify that the often sketchy, incomplete written agreements made by merchants are not intended to exclude evidence of additional consistent terms unless the parties have clearly expressed themselves otherwise.<sup>41</sup> These are the points that section 2-202 addresses. Beyond these points, the section is silent and should be supplemented by the common law under section 1-103.

## **BATTLE OF THE FORMS**

In *McJunkin Corp. v. Mechanicals, Inc.*,<sup>42</sup> the Sixth Circuit applying Ohio law, determined that a seller's remedy limitation clause contained in its form did not become part of the contract. The buyer was thus able to recover consequential damages. McJunkin Corporation (Buyer) purchased stub ends used to connect pipe segments from Alaskan Copper Companies, Inc. (Seller). Buyer resold the stub ends to a contractor for use in a pipe system the contractor was installing in a chemical plant. After installation, the stub ends proved to be defective. Buyer was held liable to the contractor for the extra expenses incurred by both the contractor and the plant owner to replace the stub ends. In the

36. Cf. *Hibbett Sporting Goods, Inc. v. Biernbaum*, 375 So. 2d 431 (Ala. 1979).

37. 776 S.W.2d 608, 10 U.C.C. Rep. Serv. 2d 65 (Tx. Ct. App. 1989).

38. The court cited several treatises in support of its conclusion.

39. A.L.I., Uniform Revised Sales Act, Proposed Final Draft No. 1, Comment on Section 15 (4/27/44); reprinted in 2 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 123-26 (1984). ("Unif. Rev. Sales Act, Prop. Final Draft No. 1").

40. U.C.C. § 2-202(a).

41. U.C.C. § 2-202(b).

42. 888 F.2d 481, 10 U.C.C. Rep. Serv. 2d 712 (6th Cir. 1989).

district court, the Buyer was held not entitled to recover from the Seller for two reasons: (i) the Seller's remedy limitation clause was held to be part of the contract, thus limiting the maximum recovery to replacement cost; (ii) the Buyer's failure to permit the Seller to cure was held to constitute a waiver of the right to recover replacement cost. On appeal, the Sixth Circuit reversed and remanded.

On the issue of whether the Seller's remedy limitation clause became part of the contract, the Sixth Circuit concluded that it did not. The facts relevant to this issue were as follows: After discussions between Buyer and Seller, Buyer issued a purchase order for the stub ends. The purchase order stated: "[b]y acknowledging receipt of this order or by supplying products described herein, Seller agrees to the terms and conditions set forth herein." Apparently the Buyer also prepaid for the goods. Soon thereafter Seller shipped the first of five installments of goods directly to the contractor. With each shipment the Seller enclosed a document containing the Seller's remedy limitation clause. This clause limited Buyer's remedies to repair, replacement or refund of the purchase price at Seller's option, and disclaimed liability for consequential damages. Apparently the Seller also sent these documents to the Buyer's head office. Five days after the first shipment, Seller sent its acknowledgement form to Buyer. This form, in large type, contained both the Seller's remedy limitation clause and a clause stating that Seller's acceptance "is expressly conditioned on purchaser's assent to" the Seller's standard conditions of sale contained in the acknowledgement.

The Sixth Circuit began its analysis by rejecting the argument that when it shipped the goods the Seller accepted the Buyer's terms. It concluded that the more reasonable interpretation of the Seller's conduct was insistence on the Seller's terms not assent to the Buyer's terms. Thus the court did not enforce the clause in Buyer's purchase order stating that shipment of goods constituted acceptance of Buyer's terms. This result accords with the general rules of contract formation: by designating what conduct constitutes acceptance, the offeror cannot force an offeree who engages in such conduct to accept if the offeree does not intend to accept. There is, however a caveat to this rule: if the offeror could reasonably infer assent from the offeree's conduct, the offeree must notify the offeror that the offeree, by engaging in the conduct, does not intend to accept.<sup>43</sup> U.C.C. section 2-206(1)(b) is an application of these rules. In *McJunkin* the Buyer might have inferred from shipment of the goods that the Seller accepted its terms, but the Seller took reasonable steps to notify the Buyer that it did not intend to accept, by enclosing its terms with the shipments and sending its acknowledgement directly to Buyer.

The Sixth Circuit then found that Seller's acknowledgement was a "definite and seasonable expression of acceptance or a written confirmation . . ." which might have operated as an acceptance under U.C.C. section 2-207(1), but did

43. *E.g.*, Restatement (Second) of Contracts § 53 Comment b (1981).

not, because the acknowledgement was expressly conditioned upon the buyer's assent to the Seller's terms.<sup>44</sup>

The court next resolved the question of whether Buyer's failure to object to Seller's remedy limitation clause indicated acceptance of that clause. The court held not. It cited *Dorton v. Collins & Aikman Corp.*<sup>45</sup> for the proposition that silence without more cannot constitute acceptance of the terms in a competing document.<sup>46</sup>

The court next proceeded to find that a contract had been formed by mutual conduct (Buyer's prepayment and Seller's shipment) under U.C.C. section 2-207(3). It then held that the Seller's remedy limitation clause was not part of the resulting contract. The court reasoned as follows: U.C.C. section 2-207(3) states that the terms of the contract "consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of [the Uniform Commercial Code]." The court reasoned that since the writings of the parties did not agree on the remedy limitation clause (Buyer's purchase order apparently was silent on remedies), this clause was not part of the contract. In passing, the court noted that, despite a "lingering attraction" for the district court's construction, which incorporated the Seller's remedy limitation clause as an immaterial alteration not objected to, its result was consistent with what the district court had held in companion litigation between the Buyer and the contractor. There the district court held a remedy limitation clause in the Buyer's form not to be part of the contract between Buyer and the contractor for the same reasons that the Sixth Circuit held the Seller's remedy limitation clause not to be part of the contract between the Buyer and Seller.

The circuit court's discussion of what terms become part of the contract under section 2-207(3) could have gone further. That discussion overlooks the fact that section 2-207(2) can be construed to be, in the words of section 2-207(3), an "other provision of this Act" that furnishes terms of the contract.<sup>47</sup>

The purpose of section 2-207(2) is to permit reasonable form clauses to become part of a contract between merchants unless objected to.<sup>48</sup> Such clauses

44. 888 F.2d at 487; 10 U.C.C. Rep. Serv. 2d at 720.

45. 453 F.2d 1161, 1168 (6th Cir. 1972) and n.4; 10 U.C.C. Rep. Serv. 585, 594, and n.4.

46. The court did not discuss whether the seller's acknowledgement constituted a counter offer which the buyer accepted by taking the goods (the so-called "Last Shot" rule). Probably this argument was not raised because of the unusual facts of this case. The Buyer prepaid before the Seller shipped; also the goods were shipped to the contractor not the Buyer. Both of these facts render this argument nugatory.

47. Probably this point was neither briefed nor argued to the court.

48. Note the multiple use of the term "reasonable" in Comments 4 and 5 to section 2-207. See also General Comment on Parts II and IV: Formation and Construction, ¶ 7. The principle of reasonable construction and against surprise at 9-11 (1948); reprinted in *The Karl Llewellyn Papers, Section J: The Uniform Commercial Code*, File J(IX)(2)(a) (Wm. S. Hein & Co., Inc. microfilm, 1987) ("General Comment"); Unif. Rev. Sales Act, Prop. Final Draft No. 1, *supra* note 39, Comment on § 20, at 129-30. See also 21 A.L.I. Proc. 98 (1944); A.L.I., Minutes of the Revised Uniform Sales Act, Conference held at New York City at 31 (Nov. 22-24, 1942) in A.L.I. Archives Drawer 182, File: Sales Act, Conference November 22-24, 1942. (Llewellyn speaking: "Both oral

cause no surprise or hardship<sup>49</sup> if incorporated into the contract, and thus do not materially alter the contract under section 2-207(2). How is one to know what form clauses are reasonable? We start with trade usage, course of performance, and course of dealing.<sup>50</sup> These are part of the agreement.<sup>51</sup> Thus, any form clause that does not differ materially from these predicates is reasonable. Next, the Code “gap-fillers,” those terms which article 2 incorporates into a contract absent contrary agreement,<sup>52</sup> provide an important guide to what form clauses are reasonable. However the Code gap-fillers do not provide the exclusive test of reasonableness. There are at least two instances in which a clause might not correspond to a Code gap-filler, but still be reasonable. First, the Code may not provide any gap-filler on the subject matter of the clause. Most of the Comment 5 examples of clauses that do not materially alter a contract under section 2-207(2)(b) are clauses of this type.<sup>53</sup> Second, the circumstances of the case may indicate that some other term, not the standard gap-filler is more reasonable. The last example in Comment 5 demonstrates this point. In that example a clause “limiting remedy in a reasonable manner (see sections 2-718 and 2-719)” is said to be a clause that would not materially alter the contract under section 2-207(2)(b). Yet the standard Code gap-fillers give an injured party a full array of remedies, not just liquidated damages or the modified remedies permitted by sections 2-718 and 2-719. Thus the example indicates that there are circumstances when it is desirable to add reasonable remedy limitations to the contract rather than the standard Code remedies. What this essentially means is that the

deals and wire deals are constantly followed by written confirmations, including additional 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.”); K. Llewellyn, *The Common Law Tradition* 370–71 (1962).

49. Comment 4 states that whether a clause “materially alter[s]” is to be determined by whether surprise or hardship would result if the clause were incorporated without express awareness by the other side. An early version of the Comment to what is now section 2-207 elaborated on this “surprise or hardship” test.

Subject therefore to the possibility of surprise by any attempted assertion of what are abnormal terms, upsetting rather than supplementing the essential terms dickered about and agreed upon any reasonable terms are to be included by silence for more than a reasonable time after receipt. Even when overlooked by the receiver, their incorporation imposes no hardship.

Unif. Rev. Sales Act Prop. Final Draft No. 1, *supra* note 39, Comment on § 20, at 129–30. *See also* General Comment *supra* note 48, at 11 (“Reasonable clauses take no man by surprise. . .”); K. Llewellyn, *The Common Law Tradition* 370 (1962) (referring to “a blanket assent (not a specific assent) to any not unreasonable or indecent terms in the form”); *Id.* at 371 (“The boilerplate is assented to en bloc, ‘unsight, unseen,’ on the implicit assumption and to the full extent that (1) it does not alter or impair the fair meaning of the dickered terms when read alone, and (2) that its terms are neither in the particular nor in the net manifestly unreasonable and unfair.”).

50. U.C.C. § 1-205; *Id.* § 2-208.

51. U.C.C. § 1-201(3).

52. U.C.C. § 2-204 Comment.

53. In a purchase for sub-sale, a clause providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices; a clause fixing the seller’s standard credit terms. U.C.C. § 2-207 Comment 5.

circumstances of the case may supply a reasonable term as part of the "agreement."<sup>54</sup>

Other arguments support the inclusion of section 2-207 subdivision (2) within subdivision (3). There is no reason why reasonable form clauses should be part of a contract formed under subdivision (1) but not part of a contract formed under subdivision (3). Indeed, not applying subdivision (2) to contracts formed under subdivision (3) can produce absurd situations. The potential for absurdity is illustrated by what happened to the seller in *McJunkin*. The seller avoided accepting the buyer's offer under subdivision (1) by expressly conditioning its form. The result was that a contract was formed by mutual conduct under subdivision (3) and the buyer automatically received a full array of remedies by application of the standard Code remedy gap-fillers. However if the seller's form had been drafted so that it operated as an acceptance of the buyer's offer under subdivision (1), then the seller's additional term limiting liability for consequential damages might have become part of the contract as a reasonable limitation of remedy under subdivision (2). By rejecting the buyer's terms the seller lost the chance to add its remedy limitation clause to the ensuing contract, a chance which it would have had if it had accepted the buyer's terms. This curious situation is not supported by the drafting history. To the contrary, a prior draft of section 2-207 explicitly stated that section 2-207, subdivision (2) is applicable to contracts formed under subdivision (3).<sup>55</sup> Reasonable terms should be part of the contract if not objected to, regardless of how the contract is formed.

In sum, when a contract is formed by mutual conduct under section 2-207 subdivision (3), subdivision (2) should be consulted to determine whether additional terms in either form become part of the contract. Consequently, in *McJunkin* the better resolution of whether the seller's consequential damages

54. Cf. U.C.C. § 1-201(3) Comment 3 ("Agreement" definition "intended to include full recognition of usage of trade, course of dealing, course of performance *and the surrounding circumstances*. . .") (emphasis added); *Id.* § 2-308 Comment 4 ("*The surrounding circumstances*, usage of trade, course of dealing and course of performance, as well as the express language of the parties, may constitute an 'otherwise agreement.'") (emphasis added); *Id.* § 2-508 Comment 2 ("Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well as in the *particular circumstances surrounding the making of the contract*.") (emphasis added). See also General Comment, *supra* note 48, at 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).") *Id.* at 22 (referring to standard provision that reasonably limits remedies as meriting a sympathetic and expansive, not hostile, application).

55. A.L.I. and N.C.C.U.S.L., Supplement No. 1 to the 1952 Official Draft of Text and Comments of the Uniform Commercial Code § 2-207(5) [now § 2-207(3)] at pages 6, 7 (Jan. 1955); reprinted in 17 A.L.I. and N.C.C.U.S.L., Uniform Commercial Code Drafts 324-25 (1984) (terms consist of "those terms on which the writings of the parties agree, together with any supplementary terms incorporated under either the next subsection [now § 2-207(2)] or any other provisions of this Act.") (material in brackets added).

exclusion clause became part of the contract should turn on whether it was reasonable under the circumstances of that case.

The Study Group appointed by the Permanent Editorial Board to study article 2 has concluded that a major revision of section 2-207 is necessary.<sup>56</sup> The Study Group recommended that the revision proceed along lines suggested by Professor John E. Murray, Jr.<sup>57</sup>

## WARRANTY OF TITLE

In *Bank of Nova Scotia v. Equitable Financial Management, Inc.*<sup>58</sup> the Third Circuit, applying Pennsylvania law, concluded that a finance lessor is not governed by the article 2 warranty of title (section 2-312). In that case the lessee (Scalise) purchased equipment that was subject to a pre-existing security interest. The lessor (Equitable) financed this purchase, and, as security, it took title to the equipment and entered into the lease with Scalise. The lease was thus a finance lease.<sup>59</sup> In a suit by the previous secured creditor against the lessee for damages, the lessee cross-claimed against the lessor for breach of the warranty of title under section 2-312. The district court found that the lessor had warranted good title because the lease gave the lessee an option to purchase the leased goods for one dollar. It concluded, however, that the lessor had not breached its warranty of title, because the circumstances should have put the lessee on notice of the previous security interest. The Third Circuit affirmed but for reasons different than those given below. The Third Circuit first held that the lease was intended to create only a security interest, so that it was not covered by article 2 generally or by section 2-312.<sup>60</sup> It then stated that even if the lease were not solely for security, the circumstances of the case gave the lessee reason to know that the finance lessor was “selling” only such right or title that its supplier might have, so that any warranty of title had been effectively disclaimed under subdivision 2-312(b).

The case reaches the correct result. Here it is the lessee who has selected the goods from the supplier and has instructed the lessor to acquire them. Under these circumstances the lessee ought not be able to throw the risk of title disputes onto the lessor. The transaction between these parties is either a true finance lease or a lease intended as security. If the transaction is a true finance

56. See Preliminary Report, Permanent Editorial Board of U.C.C. and A.L.I. and N.C.C.U.S.L., Article 2 Study Group, Part 2, *Additional Terms in Acceptance or Confirmation: 2-207*, Rec. A2.2(8), 20, 21 (Mar. 1, 1990).

57. *Id.* Prof. Murray is a member of the Study Group. Other members are: Glenn Arendsen, Prof. Amelia Boss, Prof. Steven L. Harris, Prof. Frederick H. Miller, Prof. Charles W. Mooney, Jr., Prof. James J. White, Robert W. Weeks, and Prof. Richard E. Speidel. Prof. Murray's suggestions for revision of section 2-207 are contained in Murray, *Proposed Revision of Section 2-207 of the Uniform Commercial Code*, 6 J.L. & Com. 337 (1986). See also Murray, *The Chaos of the Battle of the Forms: Solutions*, 39 Vand. L. Rev. 1307 (1986).

58. 882 F.2d 81, 9 U.C.C. Rep. Serv. 2d 1 (3d Cir. 1989).

59. Cf. U.C.C. § 2A-103(1)(g) and Comment g.

60. U.C.C. § 2-102.

lease, the lessor is a finance lessor and makes no warranty of title.<sup>61</sup> If the transaction is a lease intended as security—because the lessee has the option to become the owner of the goods for a nominal consideration (one dollar)—then the lessor's interest in the goods is not title, but a security interest,<sup>62</sup> and the lessee has title. The transaction is then, in effect, a cash sale of the goods by the supplier to the lessee with the lessor furnishing the cash on the lessee's behalf and taking a security interest in the goods to secure repayment of the cash advance. The supplier, not the lessor, is the seller, and it is the supplier, not the lessor, who warrants title under section 2-312.

## **EXPRESS WARRANTY**

In *Cipollone v. Liggett Group, Inc.*,<sup>63</sup> the Third Circuit, applying New Jersey law, considered several issues pertaining to the creation and enforcement of article 2 express warranties. Plaintiff sued defendant cigarette manufacturer for the death from lung cancer of his wife who had smoked defendant's cigarettes for much of the time between 1942 and her death in 1984. The plaintiff contended, among other theories, that the manufacturer made express warranties about the safety of its products entitling him to recover for breach of express warranty under article 2. The jury rendered a verdict for the plaintiff on this theory. On appeal the manufacturer raised several arguments about its liability for breach of express warranty. First, it contended that it made no affirmations of fact that could have become express warranties under U.C.C. section 2-313(1)(a). Second, the manufacturer argued that even if it had made such representations, they did not become part of the basis of the bargain as required by that section. Third, the manufacturer maintained that the plaintiff's wife's comparative fault in smoking cigarettes after acquiring knowledge of their harmful effects should have reduced plaintiff's recovery for breach of warranty. Finally, it contended that the conduct of plaintiff's wife in smoking cigarettes while knowing they were harmful precluded defendant's breach of warranty from being the proximate cause of her injuries under U.C.C. section 2-715.

Although the manufacturer did not directly sell cigarettes to the plaintiff's wife, the court ruled that there was sufficient evidence for the jury to conclude that the manufacturer represented to consumers that the long-term smoking of its cigarettes would not endanger their health. The court cited several of the manufacturer's advertisements which stated that cigarette smoking was safe. The court found it reasonable to infer that an unqualified representation that smoking is safe creates a warranty that smoking for a long period of time is safe. The court's ruling on this issue appears consistent with decisions in other cases

61. Cf. U.C.C. § 2A-211(2).

62. U.C.C. § 1-201(37).

63. 893 F.2d 541, 10 U.C.C. Rep. Serv. 2d 625 (3d Cir. 1990), *cert. granted*, 59 U.S.L.W. 3648, 3652 (U.S. Mar. 25, 1991) (No. 90-1038) (Court to consider whether Federal Cigarette Labeling and Advertising Act preempts state tort claims against cigarette manufacturers).

finding broad assertions of safety to constitute express warranties.<sup>64</sup> A seller's representation that a product is safe may be treated as a mere representation of the seller's opinion and not a warranty where the seller does not have any special knowledge not possessed by the buyer about the goods.<sup>65</sup> However in this case during the time the manufacturer promoted the advertisements, the 1950s through the 1960s, it may have had, and through its advertising may have purported to have had, superior information on the health effects of smoking its cigarettes. Moreover, the manufacturer's advertisements claimed to be based on extensive medical testing and appeared to be designed to overcome consumer concerns about its product's safety. Under the circumstances, it was reasonable for the trier of fact to construe a representation of safety as a warranty and not merely as the seller's opinion or commendation of the goods.

The manufacturer next contended that the advertisements, even if affirmations of fact, did not become part of the basis of the bargain as required by U.C.C. section 2-313(1)(a), because Mrs. Cipollone did not rely on those advertisements. Whether a buyer must rely upon an affirmation of fact for it to be part of the basis of the bargain has been the subject of considerable debate among courts and commentators.<sup>66</sup> In *Cipollone* the trial court instructed the jury that an affirmation becomes part of the basis of the bargain "if it would naturally induce the purchase of the product and no particular reliance by the buyer on such statement needs to be shown."<sup>67</sup>

The Third Circuit found this charge to be error, primarily because it did not require the plaintiff to prove that the buyer Mrs. Cipollone was ever aware of the affirmation.<sup>68</sup> It also disapproved the charge because it was inconsistent with the Official Comments to U.C.C. section 2-313: two of those comments envisage a mechanism for overcoming the presumption that the seller's affirmations, even if heard by the buyer, are a basis of the bargain. The jury charge provided no such mechanism. The court also rejected the manufacturer's presumption of reliance theory. Under that theory reliance is presumed if the affirmation would reasonably induce the purchase, but the seller can rebut this presumption by proving that the buyer did not rely on the affirmation. The court rejected this theory for the reason that it put a heavy burden on the buyer to give evidence of reliance. The court concluded that this burden was inconsistent with the U.C.C. as a whole and several comments to U.C.C. section 2-313.<sup>69</sup>

The Third Circuit developed a three-step test that deemphasized reliance, yet required that the buyer be aware of the affirmation: first, the buyer must prove

64. See *Drayton v. Jiffe Chem. Corp.*, 591 F.2d 352, 26 U.C.C. Rep. Serv. 865 (6th Cir. 1978); *Hauter v. Zogarts*, 14 Cal. 3d 104, 534 P.2d 377, 120 Cal. Rptr. 68, 16 U.C.C. Rep. Serv. 938 (1975).

65. See *Weiss v. Rockwell Mfg. Co.*, 9 Ill. App. 3d 906, 293 N.E.2d 375, 12 U.C.C. Rep. Serv. 429 (1973); accord *Royal Business Machs., Inc. v. Lorraine Corp.*, 633 F.2d 34, 44, 30 U.C.C. Rep. Serv. 462 (7th Cir. 1980).

66. See B. Clark & C. Smith, *The Law of Product Warranties* 4-27-4-36 (1984).

67. 893 F.2d at 563, 10 U.C.C. Rep. Serv. 2d at 642.

68. 893 F.2d at 569, 10 U.C.C. Rep. Serv. 2d at 650.

69. 893 F.2d at 567, 10 U.C.C. Rep. Serv. 2d at 647-48.



that it was aware of the affirmation.<sup>70</sup> Proof of buyer awareness of the affirmation creates a rebuttable presumption that the affirmation is part of the basis of the bargain. Second, the seller can rebut this presumption by proving that the buyer knew the affirmation to be untrue.<sup>71</sup> This step, the court believed to be required by the Official Comments, traditional contract principles, and New Jersey caselaw. Third, if the seller does prove that the buyer knew the affirmation to be false, the buyer can still prove that it relied upon the affirmation to establish a warranty.<sup>72</sup> "It is possible to disbelieve, but still rely on, the existence of a warranty. In this sense the buyer can 'buy' a lawsuit."<sup>73</sup>

The Third Circuit thus adopted a test requiring that the buyer be aware of the affirmation or promise in order for it to be an express warranty. This is clearly what is contemplated by the comments to U.C.C. section 2-313. Those comments variously describe statements that become express warranties as those that "rest on 'dickered' aspects of the bargain";<sup>74</sup> or that are "part of a negotiation which ends in a contract."<sup>75</sup> Even the comment which states that postsale affirmations can be express warranties contemplates the buyer being aware of the affirmations: "[i]f language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance). . . ."<sup>76</sup> Finally use of the word "bargain" throughout the text and comments of U.C.C. section 2-313 supports a requirement that the buyer be aware of the affirmations.

The court of appeals also considered the relevance of Mrs. Cipollone's knowledge of the hazards of smoking cigarettes with respect to two other U.C.C. issues. The first was whether Mrs. Cipollone's knowledge warranted an instruction that she was comparatively at fault, thereby reducing Liggett's liability for breach of express warranty. Citing New Jersey decisions allowing comparative fault to limit or bar recovery for breach of an implied warranty,<sup>77</sup> the court stated in dictum that the maker of an express warranty could invoke comparative fault as a defense if it could show that a buyer misused or abused a product or used the product after learning the warranty was false. The court stated, however, that for the defense to have been available in *Cipollone*, it would have been necessary for the manufacturer to have established that Mrs. Cipollone purchased cigarettes while still believing manufacturer's express warranties, smoked cigarettes after learning that the representations were false, and then contracted cancer from those specific cigarettes. Determining that no reasonable jury could make such a finding, the court concluded that comparative fault was not a defense.

70. 893 F.2d at 567, 10 U.C.C. Rep. Serv. 2d at 648-49.

71. 893 F.2d at 568, 10 U.C.C. Rep. Serv. 2d at 649.

72. 893 F.2d at 568 n.31, 10 U.C.C. Rep. Serv. 2d at 649 n.31.

73. 893 F.2d at 568 n.31, 10 U.C.C. Rep. Serv. 2d at 649 n.31.

74. U.C.C. § 2-313 Comment 1.

75. *Id.* Comment 3.

76. *Id.* Comment 7.

77. See *Cintrone v. Hertz Truck Leasing & Rental Serv.*, 45 N.J. 434, 212 A.2d 769 (1965); *Maiorino v. Weco Prods. Co.*, 45 N.J. 570, 214 A.2d 18 (1965).

Mrs. Cipollone's knowledge of the falsity of the manufacturer's affirmations raised the final question whether such knowledge precluded her injury from being the proximate result of Liggett's breach of warranty as required by U.C.C. section 2-715(2)(b). Comment 5 to that section indicates that if a buyer discovers a defect in goods prior to its use of the product, any injury resulting from the defect would not proximately result from the breach of warranty. In such a situation, it would not be reasonable to foresee that a buyer, having learned of the defect and risk of injury, would continue to use the product. Moreover, allowing a buyer to recover consequential damages once it learned of the breach would be inconsistent with the general contract principle of mitigation of damages. Consistently with its ruling on the defense of comparative fault, the court of appeals ruled that evidence of Mrs. Cipollone's knowledge of the falsity of the manufacturer's affirmations concerning the safety of its cigarettes was irrelevant to the causation issue under U.C.C. section 2-715 since, on the facts of this case, her knowledge that the representations were false would have precluded the affirmations from being part of the basis of the bargain and thus not warranties in the first place.

## ***IMPLIED WARRANTY OF FITNESS FOR PARTICULAR PURPOSE***

Courts continue to differ on whether an ordinary purpose of goods under U.C.C. section 2-314 (merchantability warranty) can be a particular purpose under U.C.C. section 2-315 (warranty of fitness for particular purpose).

In *Lorfano v. Dura Stone Steps, Inc.*,<sup>78</sup> the Maine Supreme Judicial Court said no. In that case the court affirmed a grant of summary judgment in favor of the seller of prefabricated concrete steps. The plaintiff, an employee of the buyer, was injured when he fell from the side of the steps. His suit against the seller was based on the fact that no handrail had been installed. He alleged this failure to be a breach of the warranties of merchantability and fitness for particular purpose. Apparently the seller had offered to sell handrails to the buyer who had declined to purchase them. The warranty of fitness for particular purpose does not arise unless the buyer relies on the seller to select suitable goods.<sup>79</sup> In this case, the buyer obviously did not rely on the seller in not purchasing handrails. Thus, on these facts the court reached the proper conclusion that there could be no warranty of fitness for particular purchase.

In *Great Dane Trailer Sales, Inc. v. Malvern Pulpwood, Inc.*,<sup>80</sup> the Arkansas Supreme Court, in effect, held that an ordinary purpose could be a particular purpose and so create an implied warranty of fitness for particular purpose. In that case the buyer (Malvern Pulpwood) purchased two pulpwood trailers from the seller-manufacturer (Great Dane) to be used for hauling pulpwood. Within a year both trailers broke in the same spot. Replacement trailers also broke in

78. 569 A.2d 195, 11 U.C.C. Rep. Serv. 2d 39 (Me. 1990).

79. U.C.C. § 2-315.

80. 301 Ark. 436, 785 S.W.2d 13, 11 U.C.C. Rep. Serv. 2d 875 (1990).

the same spot. The buyer then sued for breach of the warranties of merchantability and fitness for particular purpose. The seller defended on the ground of a "repair or replacement" warranty and disclaimer. The jury returned a verdict for the buyer only on the fitness warranty, as it was not instructed on the warranty of merchantability.<sup>81</sup> On appeal, the supreme court affirmed. It ruled that the trial court had correctly denied the seller's motion for summary judgment so that the case had properly been submitted to the jury. In arguing that its summary judgment motion should have been granted, the seller maintained that the warranty of fitness could arise only where the buyer had a particular purpose other than an ordinary purpose of the goods. The court rejected this argument, citing a federal district court case<sup>82</sup> and U.C.C. section 2-317 which, the court said, provides that warranties shall be construed as cumulative with each other.

These cases reflect the substantial split of authority on the question of whether an ordinary purpose of goods can be a particular purpose and so give rise to a warranty of fitness for that particular purpose under U.C.C. section 2-315.<sup>83</sup>

## **EXCLUSION OR MODIFICATION OF WARRANTIES**

In two cases this year courts found written disclaimers of the warranty of merchantability to be effective under U.C.C. section 2-316(2) even though the disclaimers did not mention merchantability as that subsection requires. The first case is *Dairyland Insurance Co. v. General Motors Corp.*<sup>84</sup> decided by the Alabama Supreme Court. In that case the buyer purchased a new van from a Chevrolet dealer and quickly experienced trouble with the electrical system. Some eight months later the van burned, apparently as a result of a short in the electrical system. The buyer sued both the manufacturer and the dealer on a variety of theories including breach of the implied warranty of merchantability. The trial court granted summary judgment for both the manufacturer and dealer on all counts.

On appeal the Alabama Supreme Court reversed as to the buyer's warranty claims and one of its tort claims. On rehearing, the court modified its earlier opinion by affirming the trial court's dismissal of the warranty claims against the dealer. The court based its modified opinion upon a warranty disclaimer clause appearing in the sale contract which the court held to be effective to disclaim the implied warranty of merchantability.

On this point, the court's opinion rests on a puzzling application of U.C.C. section 2-316(2). The court quoted the language of subdivision 2-316(2) which

81. 301 Ark. at 443, 785 S.W.2d at 17, 11 U.C.C. Rep. Serv. 2d at 879.

82. *Beech Aircraft Corp. v. Flexible Tubing Corp.*, 270 F. Supp. 548 (D. Conn. 1967).

83. See B. Clark & C. Smith, *The Law of Product Warranties* ¶ 6.02[2] nn.26, 27 (1984); cases are collected in Annotation, *Uniform Commercial Code: Implied Warranty of Fitness for Particular Purpose As Including Fitness for Ordinary Use*, 83 A.L.R. 3d 656 (1978).

84. 549 So. 2d 44, 9 U.C.C. Rep. Serv. 2d 903 (Ala. 1989).

requires that disclaimers of the implied warranty of merchantability be conspicuous and mention the word merchantability. Noting that the disclaimer language was in bold print, the court quoted the exact language of the disclaimer.<sup>85</sup> That language did not use the word merchantability. Nevertheless the court held the disclaimer to be effective. The court stated that the disclaimer was similar to one it had previously held to be effective in *Wilburn v. Larry Savage Chevrolet, Inc.*<sup>86</sup> In fact, the disclaimer held to be effective in *Wilburn* did mention the word merchantability.<sup>87</sup> Thus, the court's quotation of subdivision 2-316(2) is puzzling.

On closer reading, however, it is clear that the court's decision probably rests on the provisions of U.C.C. section 2-316(3)(a). If the disclaimer does not mention merchantability, there is no authority under U.C.C. section 2-316(2) for finding such a disclaimer to be effective to disclaim the implied warranty of merchantability. The only alternative would be for the court to base its decision on the provisions of subdivision 2-316(3)(a), which provides that all implied warranties may be disclaimed by "language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty." The *Dairyland* court, in fact, cites two other cases that do rely on subdivision 2-316(3)(a).<sup>88</sup> Unfortunately, these cases are cited without comment, except to suggest that they support the holding of the *Wilburn* case.

Although the court could have based its decision in *Dairyland* on subdivision 2-316(3)(a), it is not clear that doing so is justified under the facts of the case. *Dairyland* involved the sale of a new van that burned within eight months of purchase. Subdivision 2-316(3)(a) states that general language of disclaimer is not effective if "the circumstances indicate otherwise."<sup>89</sup> It may be that the circumstances of the case at least raise a question of fact which should have been sufficient to defeat the Chevrolet dealer's summary judgment motion.

In *Travel Craft, Inc. v. Wilhelm Mende GmbH & Co.*<sup>90</sup> the Indiana Supreme Court held disclaimer language drafted by the buyer and which did not mention merchantability to be effective to disclaim the implied warranty of

85. The language of the disclaimer was:

Warranties Seller Disclaims. You understand that the Seller is not offering any warranties and there are no particular purpose, or any other warranties, express or implied by the Seller, covering the vehicle unless the Seller extends a written warranty or service contract within 90 days from the date of this contract. 549 So. 2d at 48, 9 U.C.C. Rep. Serv. 2d at 907.

86. 477 So. 2d 384 (Ala. 1985).

87. *Id.* at 386.

88. The two cases are: *Gaylord v. Lawler Homes, Inc.*, 477 So. 2d 382, 42 U.C.C. Rep. Serv. 131 (Ala. 1985); *Gilliam v. Indiana National Bank*, 337 So. 2d 352, 20 U.C.C. Rep. Serv. 307 (Ala. Civ. App. 1976).

89. For a discussion of the drafting history of "the circumstances indicate otherwise" phrase of U.C.C. section 2-316(3)(a), see Frisch & Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title*, 44 Bus. Law. 1445, 1459 n.70 (1989).

90. 552 N.E.2d 443, 11 U.C.C. Rep. Serv. 2d 1141 (Ind. 1990).

merchantability. The case is a good example of proper interpretation of the Code. Comment 1 to U.C.C. section 1-102 states, "[t]he text of each section should be read in the light of the purpose and policy of the rule or principle in question. . . ."<sup>91</sup> The court identified the purpose of requiring a disclaimer to mention merchantability to be "to protect a buyer from unexpected and unbar-gained language of disclaimer. . . ."<sup>92</sup> The court concluded that where, as here, the buyer drafts the disclaimer clause, this purpose is satisfied and the disclaimer is effective. Where the reason for the rule stops, there stops the rule.

*Trans-Aire International, Inc. v. Northern Adhesive Co., Inc.*<sup>93</sup> decided by the Seventh Circuit and applying Illinois law is a good illustration of the application of U.C.C. section 2-316(3)(b) under which an examination of the goods by the buyer prior to contracting can result in the exclusion of implied warranties. In that case the buyer (Trans-Aire) contacted the seller (Northern) regarding the purchase of adhesive to be used in installing fabric in recreational vehicles. Buyer was interested in obtaining a substitute for another adhesive that had failed to adhere in hot climates. After being informed of the purpose for which buyer needed the adhesive, seller sent several samples to buyer "for experimentation purposes."<sup>94</sup> Successful tests were conducted in a cool plant, leading buyer's chief engineer, Fribley, to conclude that seller's Adhesive 7448 was superior to the adhesive previously used. Fribley's uncontradicted testimony was that he informed buyer's president that additional tests should be conducted in a heated environment. Nevertheless buyer's president stated that he was satisfied with the product, and an order was placed. Seller's adhesive also failed to adhere in hot climates, and buyer sued for, among other things, breach of the implied warranties of merchantability and fitness for a particular purpose.

The trial court granted seller's motion for summary judgment on the ground that the implied warranties had been excluded by buyer's examination and testing of the samples. The Seventh Circuit affirmed, relying on U.C.C. section 2-316(3)(b) and its comments.<sup>95</sup> Quoting Official Comment 8, the court held that, "[a] professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe." Even though tests conducted in a cool environment did not reveal defects in the adhesive, buyer was aware of the problems encountered with a similar adhesive in hot climates. There was no proof by buyer that heat testing could not be performed. Seller, on the other hand, suggested that heat testing could easily be accomplished by placing a sample in an oven or by sending a sample to an independent laboratory. Thus the buyer's testing was held to

91. U.C.C. § 1-201 Comment 1.

92. *Id.* § 2-316 Comment 1.

93. 882 F.2d 1254, 9 U.C.C. Rep. Serv. 2d 878 (7th Cir. 1989).

94. 882 F.2d at 1256, 9 U.C.C. Rep. Serv. 2d at 880.

95. U.C.C. section 2-316(3)(b) provides in pertinent part "when the buyer before entering into the contract has examined the goods . . . as fully as he desired . . . there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him. . . ."

negate any implied warranty that the adhesive would perform satisfactorily in hot climates.

U.C.C. section 2-316(3)(b) places a heavy burden on the buyer who undertakes to examine goods or samples prior to contracting. A buyer who does so would be well advised to obtain express warranties from the seller.

## **TITLE, CREDITORS, AND GOOD FAITH PURCHASERS**

In years past, conflict between U.C.C. section 2-403 and certificate of title laws has often appeared as an issue. This year, the cases that involve certificate of title laws do so only peripherally and generally rely on U.C.C. section 2-403 as the primary rule of decision. In *Suburban Motors, Inc. v. State Farm Mutual Automobile Insurance Co.*,<sup>96</sup> a case of first impression, a California court reached the rather unremarkable conclusion that a good faith purchaser of an automobile cannot acquire good title where the chain of conveyances includes a theft, despite the facial validity of the certificate of title.<sup>97</sup> The court noted that, according to the terms of U.C.C. section 2-403, the transfer of title is effectuated only through a voluntary transaction of purchase. A transfer by theft is neither voluntary nor a transaction of purchase. The thief acquires no title and thus can convey none; even the good faith purchaser status of a subsequent transferee cannot cure this deficiency. Moreover, the "full title" doctrine, which was urged upon the court by the innocent transferee, is not applicable to a transfer which is tainted by a previous theft. This doctrine, permitting exclusive reliance upon a valid certificate of title, operates only to defeat unlisted security interests. In this case, the plaintiff is the insurance company of the original owner claiming ownership of the vehicle, not merely a security interest. The court noted the impossibility of the insurance company protecting its interests by "giving notice to good faith purchasers who . . . take under a spurious chain of title dependent on 'laundered' title documents."<sup>98</sup>

In a case of apparent first impression, an Illinois court determined that for purposes of U.C.C. section 2-403(2),<sup>99</sup> a mistaken transfer of goods to a merchant dealing in goods of that kind does not constitute an entrustment. In *Kahr v. Markland*,<sup>100</sup> plaintiff transferor donated some bags of what he thought contained only used clothing to a Goodwill store. In reality, one of the sacks contained valuables not intended for donation, including 28 pieces of sterling

96. 11 U.C.C. Rep. Serv. 2d 56 (Cal. Ct. App. 1990).

97. The clean California certificate was based on a certificate of title from Louisiana. The court speculates that the Louisiana certificate came from a previously damaged vehicle registered in Louisiana which was falsely represented to authorities in that state as "rebuilt." *Id.* at 58 n.1.

98. *Id.* at 63. Also decided this survey period was *Robinson v. Durham*, 537 So. 2d 966, 9 U.C.C. Rep. Serv. 2d 563 (Ala. Cir. App. 1988), which dealt with facts almost identical to those in *Suburban Motors*. As in *Suburban Motors*, the court in *Robinson* ruled that good title cannot be acquired by even a good faith purchaser once a theft has tainted the chain of conveyances.

99. U.C.C. section 2-403(2) provides that "[a]ny entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."

100. 187 Ill. App. 3d 603, 543 N.E.2d 579, 10 U.C.C. Rep. Serv. 2d 355 (1989).

silver. Shortly after receiving the silver, Goodwill sold it to defendant for \$15.00.

Appealing from a judgment awarding the silver to plaintiff, defendant contended that she was entitled to protection under U.C.C. section 2-403(2). The appellate court ruled that this provision did not apply because the silver was not entrusted to Goodwill. The court relied on the Illinois commentary accompanying U.C.C. section 2-403(3), which states that entrusting "includes any voluntary transfer of possession by . . . the entrustor."<sup>101</sup> The court ruled that the transfer of the silver to Goodwill was not a voluntary transfer since plaintiff unknowingly transferred the silver to Goodwill. Having decided that defendant was not protected by U.C.C. section 2-403, the court found that the silver was lost property subject to recovery by owners.

As acknowledged in the concurring opinion of Justice Lund, a strong argument can be made that the description of entrusting under U.C.C. section 2-403 should include the mistaken delivery of goods. As between a buyer in the ordinary course of business, who by definition must be ignorant of the fact that his purchase violates the ownership rights of the transferor, and the mistaken transferor, the latter appears to be in a superior position to protect against the mistaken transfer of the goods through the exercise of reasonable care.

Although not dispositive in the *Kahr* case, defendant's lack of good faith could arguably have been made the basis of the ruling favoring plaintiff, since the defendant testified that she knew at the time of purchase that the silverware was not stainless steel. According to the definition found in U.C.C. section 1-201(9), good faith is a necessary attribute of anyone hoping to qualify as a buyer in ordinary course.<sup>102</sup>

The buyer's good faith played a greater role in *Barco Auto Leasing Corp. v. Holt*.<sup>103</sup> In *Barco*, plaintiff purchased an automobile from Exotic Car Leasing Corp., then leased the vehicle back to Exotic. Sometime thereafter, Exotic sold the car to defendant. Plaintiff sued for conversion and its motion for summary judgment was granted in the lower court.<sup>104</sup> The court of appeals reversed, holding that under U.C.C. section 2-403(2), defendant received a valid title as long as he qualifies as a buyer in ordinary course. Because the record contained insufficient evidence on the question of the buyer's good faith, this issue presented a question of fact making summary judgment improper.<sup>105</sup>

101. Ill. Ann. Stat. 26-2-403(3), Illinois Code Comment 331 (Smith-Hurd 1963).

102. A buyer in ordinary course of business is defined as "a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind. . . ." U.C.C. § 1-201(9).

103. 228 N.J. Super. 77, 548 A.2d 1161, 9 U.C.C. Rep. Serv. 2d 111 (1988).

104. The trial court based its decision on common law principles of conversion without considering what impact the Code might have on the superiority of the plaintiff's present right of possession.

105. The defendant never received the title documents until sometime after the sale, and then under circumstances raising questions about their validity. The court does state that one can be a buyer in ordinary course even if a certificate of title is never acquired. Other jurisdictions support

*CIBA-Geigy Corp. v. Flo-Lizer, Inc. (In re Flo-Lizer, Inc.)*<sup>106</sup> highlights the willingness of some courts to look beyond the label which the parties attach to a particular transaction in order to discern its true nature.<sup>107</sup> In that case, CIBA-Geigy, the manufacturer of an herbicide, nominally sold its product to its distributor, Kova, Inc., but indicated on the bills of lading that the product was to be delivered to CIBA-Geigy and warehoused at Flo-Lizer. After Flo-Lizer filed for bankruptcy, CIBA-Geigy initiated an adversary proceeding seeking a judgment that the herbicide was not property of the bankruptcy estate.<sup>108</sup>

Evaluating the facts and circumstances of the relationship, the court found that a sale or return, not a warehousing venture, was intended. Particularly revealing was the fact that the quantity of herbicide delivered to Flo-Lizer was based not on the storage needs of CIBA-Geigy, but on the sales capabilities of Flo-Lizer. The court also found it relevant that the arrangement was instigated by CIBA-Geigy and that Flo-Lizer was to receive compensation beyond the "storage" period.

Having identified the relationship as a "sale or return," the court applied section 2-326(3)<sup>109</sup> to determine that CIBA-Geigy would not be entitled to protection from the claims of Flo-Lizer's creditors. Because CIBA-Geigy had delivered goods to a business dealing "in goods of the kind . . . , under a name other than the name of the person making delivery,"<sup>110</sup> its failure to comply with any of three alternatives offered by the provision for protecting a consignor's interests left the herbicide available for satisfaction of Flo-Lizer's creditors' claims.<sup>111</sup>

this view. See Frisch & Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title*, 45 Bus. Law. 2289, 2307 (1990). However, the court indicates an unwillingness to recognize the plaintiff's interest unless it can produce a certificate of title in compliance with Florida law. See F.S.A. § 319.22(1) ("no court shall recognize the right, title, claim, or interest of any person in or to any motor vehicle or mobile home sold, disposed of, mortgaged, or encumbered, unless evidenced by a certificate of title duly issued to that person. . . .").

106. 100 Bankr. 341, 10 U.C.C. Rep. Serv. 2d 765 (S.D. Ohio 1989).

107. For a case decided this survey period in which the court seemingly deferred to the parties' characterization of the transaction, see *Beverage Products Corp. v. Robinson*, 27 Ark. App. 225, 769 S.W.2d 424, 9 U.C.C. Rep. Serv. 2d 565 (1989) (the court accepted documentary recitation that the arrangement was a "loan").

108. Technically, the issue presented for resolution was whether the herbicide was property of the estate, not whether it would be available to satisfy third-party claims. These are two distinct issues, yet the court seems to assume that the status of property as part of the debtor's estate is implicit in the finding of a sale or return relationship. More accurately, the failure of CIBA-Geigy to protect its interest under U.C.C. section 2-326(3) presumably permitted the avoidance of that interest under 11 U.S.C.A. § 544(b) (West 1979).

109. The court's characterization of the transaction as a "sale or return" was probably intended to mean only that the delivery of the herbicide is "deemed to be on sale or return. . . ." U.C.C. § 2-326(3) (emphasis added).

110. *Id.*

111. In another case decided this reporting period, *In re Sullivan*, 9 U.C.C. Rep. Serv. 2d 552 (Bankr. N.D. Miss. 1989), a consignor's property was held to be protected because it had complied with U.C.C. section 2-326(3) by erecting a sign identifying the property as its own. The usefulness of this alternative is severely limited by the fact that only two states, Mississippi and North Carolina



The most interesting aspect of the case is the court's determination that actual authority to sell is not necessary for the relationship to qualify as a sale or return. According to the court, the "for sale" element<sup>112</sup> is satisfied if it can be shown that the one to whom the goods were delivered had the apparent power to sell. Notice that this interpretation of U.C.C. section 2-326(3) creates in effect a creditors' version of U.C.C. section 2-403(2). Whether this reading of U.C.C. section 2-326(3) is preferable as a matter of policy will depend in large measure on the extent to which creditors rely on their debtors' possession of specific assets. Recent scholarship strongly suggests that their reliance is far less than was previously believed.<sup>113</sup>

## **RISK OF LOSS**

Sellers wishing to obtain a backdoor priority if their buyers end up in bankruptcy should consider the holding in *Crysen/Montenay Energy Co. v. Esselen Associates Inc. (In re Crysen/Montenay Energy Co.)*.<sup>114</sup> In 1985, Crysen agreed to supply fuel oil to Consolidated Edison company of New York, Inc. ("Con Edison"). To determine the quantity of oil delivered in a given shipment, an independent inspector would gauge the amount of oil received in Con Edison's shore tanks. In the absence of these measurements, the contract provided for the substitution of vessel discharge figures. In 1986, Crysen agreed to purchase fuel oil from Esselen. Because Crysen intended to resell the oil purchased from Esselen to Con Edison, it directed Esselen to deliver directly to Con Edison's terminal in New York harbor.

Controversy arose when the independent inspector found on one occasion that Esselen's vessel discharged 113,255.93 barrels of oil at Con Edison's terminal, but that only 99,719.02 barrels found their way into Con Edison's shore tanks. Accordingly, Con Edison paid Crysen the price for only 99,719.02 barrels and Crysen in turn paid the same to Esselen. In February 1986, Esselen sued Crysen to recover the purchase price of the "missing barrels." This suit was later dismissed in June of that same year when Crysen filed for bankruptcy. In 1987, Esselen filed suit against Con Edison, alleging that it had converted or misappropriated the lost barrels. Crysen sought to enjoin that action, claiming

have sign laws. See Miss. Code Ann. § 15-3-7 (1972 & 1989 Cum. Supp.); N.C. Gen. Stat. §§ 66-72 (1975).

The recommendation of the Article 2 Study Group is that U.C.C. section 2-326(3) be rewritten to make compliance with article 9 filing requirements the only alternative available to consignors wishing to protect their property from the claims of the consignee's creditors. See Preliminary Report, Rec. A.2.3(18)(B)(1).

112. U.C.C. section 2-326(3) begins with the requirement that the goods must be "delivered to a person for sale. . . ."

113. 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. Rev. 683 (1988).

114. 11 U.C.C. Rep. Serv. 2d 881 (2d Cir. 1990).

that the tort action against Con Edison was the exclusive property of the bankruptcy estate.<sup>115</sup> The bankruptcy court agreed; the district court disagreed.

The Second Circuit sided with the bankruptcy court. Whether the tort action was the exclusive property of Crysen's estate depended upon Esselen's right to sue under U.C.C. section 2-722.<sup>116</sup> After dealing with the issues of whether Esselen has either title,<sup>117</sup> a security interest,<sup>118</sup> an insurable interest<sup>119</sup> or risk of loss under U.C.C. section 2-509<sup>120</sup> with regard to the missing oil and determining that it did not, the court turned to Esselen's argument that it "has since the injury assumed the risk [of loss] as against the other."<sup>121</sup> The court found nothing in the record to suggest that Esselen had given up any claim it might have against Crysen. While acknowledging that Esselen's suit against Crysen had been dismissed, the court noted that it was dismissed without prejudice. Finally, declining to decide the case on the basis of section 2-722 alone, the Second Circuit observed that if Esselen were permitted to sue, principles of collateral estoppel and *res judicata* would require that it also sue on behalf of Crysen<sup>122</sup>—something not permitted because of the reorganization aspect of the controversy.

The decision in *Crysen* represents a very broad reading of U.C.C. section 2-722. Under the decision, a seller would seem to have the statutory right to

115. 11 U.S.C.A. section 362(a)(3) (West 1979 & Supp. 1991) automatically stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate. . . ." 11 U.S.C.A. section 541(a)(1) defines property of a debtor's estate as including "all legal or equitable interests of the debtor in property as of the commencement of the case." Whether something qualifies as property of the estate will depend, at least in part, on the debtors' rights with respect to the property under state law. *See, e.g., In re Howard's Appliance Corp.*, 874 F.2d 88 (2d Cir. 1989).

116. U.C.C. section 2-722 provides in pertinent part:

Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

(a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other. . . .

117. Because Esselen delivered the fuel oil to the designated site, title had passed to Crysen under U.C.C. section 3-401.

118. Esselen did not have a security interest in the oil because there had been no compliance with the applicable provisions of article 9.

119. The moment title passed to Crysen, Esselen lost its special property interest and no longer had an insurable interest. *See* U.C.C. § 2-501.

120. Once the oil was delivered to Con Edison's terminal, the risk of loss passed to Crysen under U.C.C. section 2-509(1)(b).

121. U.C.C. § 2-722(a).

122. The court fails to mention precisely which principles of collateral estoppel and *res judicata* would work to Crysen's prejudice. It is basic hornbook law that only persons who were parties or who are in privity with parties are bound by *res judicata* or collateral estoppel. *See generally* 18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure: Jurisdiction* §§ 4448-62 (1981).

proceed directly against a sub-purchaser provided proper steps were taken to release its claim against the immediate purchaser.<sup>123</sup>

It could be argued that if the oil was indeed lost after delivery to Con Edison, then the section should be inapplicable regardless of whether the actions of Con Edison were tortious. As between Esselen and Crysen, there simply would be no risk for Esselen to assume—the risk of loss would be borne by Con Edison.<sup>124</sup> To hold otherwise is to turn U.C.C. section 2-722 into a vehicle for providing additional security to sellers.<sup>125</sup> Presumably, it was drafted with a quite different function in mind.

## ***TENDER, CURE, AND NOTICE***

As the cases considering U.C.C. section 2-607(3)(a) continue to accumulate, the jurisprudence surrounding this section has taken on a complexity which few other sections in article 2 can rival. Not only does one encounter the inevitable slew of cases wrestling with the amorphous requirement that notice must be given “within a reasonable time”;<sup>126</sup> one also sees the nonuniform recognition of a growing number of distinctions built upon party identity and the nature of the claim.

In *Board of Education of City of Chicago v. A, C, & S, Inc.*,<sup>127</sup> the Supreme Court of Illinois was faced with a multi-count complaint filed against various defendants who were in some way involved with the distribution of asbestos-containing material.<sup>128</sup> Conceding that no formal notice was given, the plaintiffs argued that their litigation filing served as adequate notification.<sup>129</sup> While the court agreed that in an appropriate case the filing of a complaint could satisfy

123. By not deciding in the first instance whether Con Edison bore the risk of loss at the time the oil disappeared, the opinion leaves the impression that it does not matter. Yet, if the risk had already passed to Con Edison then its behavior toward the oil would be irrelevant (it would owe the purchase price regardless of any wrongdoing). If that is so, logic suggests that Con Edison's behavior is also irrelevant for purposes of Esselen's claim under U.C.C. section 2-722. In a footnote the court does mention that title and the risk of loss may not have passed to Con Edison, but it does so for the limited purpose of pointing out that Crysen may also have a claim under U.C.C. section 2-722. 11 U.C.C. Rep. Serv. 2d 887 n.1.

124. Esselen would have an action for the price against Crysen, and Crysen would, in turn, have an action for the price against Con Edison. The application of U.C.C. section 2-722 only makes sense if Con Edison is not otherwise obligated to pay for the oil.

125. If allowed to recover the purchase price directly from Con Edison, Esselen would escape the effects of Crysen's bankruptcy and Crysen's other creditors would be deprived of the full purchase price owed by Con Edison.

126. U.C.C. section 2-607(3)(a) requires that “[t]he buyer must within a reasonable time after he discovers or should have discovered any breach, notify the seller of breach or be barred from any remedy.”

127. 131 Ill. 2d 428, 10 U.C.C. Rep. Serv. 2d 90 (1989).

128. For a discussion of the court's disposition of other issues, including the several tort-based theories of recovery advanced by plaintiffs, see *supra* notes 6–7 and accompanying text.

129. Curiously, the court does not respond to the plaintiffs' contention that notice was also supplied by a previously filed (1983) class action suit on behalf of all U.S. elementary and secondary schools against virtually all of the present defendants.

the statute it held that this was not such a case. The distinction drawn was that here, no personal injuries were alleged and the plaintiffs were a body politic and not consumers.<sup>130</sup>

Compare *Chemtrol Adhesives, Inc. v. American Manufacturers Mutual Ins. Co.*<sup>131</sup> Before the Supreme Court of Ohio was a breach of warranty claim filed by the subrogee (Lexington Insurance Company) of the buyer, Chemical Adhesives, Inc. ("Chemical"). Both the trial court and the court of appeals adopted what might be referred to as a strict standard of notice, requiring that the notice must indicate that the transaction is "claimed to involve a breach."<sup>132</sup> Hence, both courts agreed that the subrogee's claim was barred as a matter of law where the only evidence of notice consisted of allegations that the seller knew that the machine sold to Chemical had malfunctioned and that the seller had, in fact, inspected Chemical's facility shortly after the damage was sustained. The supreme court, however, opted for the more liberal view of notice reflected in the first sentence of the second paragraph of Comment 4 to U.C.C. section 2-607 which reads: "the content of notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched."<sup>133</sup> Moreover, the court did not rule out the possibility that this notice may be inferred. However, in the event the fact-finder later determined that even under this lenient standard the notice was insufficient, the court turned to the question of whether the subrogee's filing of this complaint could fulfill the notice requirement. Refusing to draw distinctions based on status or the nature of the injury, the court stated that a filing could be sufficient, but not where, as here, the claim is filed more than two years after the damages were sustained.

A different distinction surfaced in *Daugherty v. Farmers Cooperative Association*.<sup>134</sup> In *Daugherty*, the original action was brought by plaintiffs against, among others, Stauffer Chemical Company ("Stauffer") for injuries caused by their use of Cythion 5-E (malathion). Following the trial court's dismissal of the case on statute of limitations grounds and the subsequent reversal by the Supreme Court of Oklahoma, Stauffer impleaded the manufacturer of the drug,

130. For the relevance of this distinction, the court cites 4 R. Anderson, Uniform Commercial Code § 2-607:38, at 142-43 (1983).

131. 42 Ohio St. 3d 40, 537 N.E.2d 624, 9 U.C.C. Rep. Serv. 2d 88 (1989). For more on this case, see *supra* notes 1-5 and accompanying text.

132. This strict approach finds support in the last sentence of comment 4 to U.C.C. section 2-607 which reads: "[t]he 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, and thus opens the way for normal settlement through negotiation." (Emphasis added.) Cases which have applied this standard include *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 19 U.C.C. Rep. Serv. 353 (5th Cir. 1976); *Roth Steel Products v. Sharon Steel Corp.*, 705 F.2d 134, 35 U.C.C. Rep. Serv. 1435 (6th Cir. 1983).

133. The court reiterated this position in *AGF, Inc. v. Great Lakes Heat Treating Co.*, 51 Ohio St. 3d 177, 11 U.C.C. Rep. Serv. 2d 859 (1990). Other cases applying this standard include *Prutch v. Ford Motor Co.*, 618 P.2d 657, 29 U.C.C. Rep. Serv. 1507 (Colo. 1980); *Paulson v. Olson Implement Co.*, 107 Wis. 2d 510, 319 N.W.2d 855, 34 U.C.C. Rep. Serv. 146 (1982).

134. 790 P.2d 1118, 11 U.C.C. Rep. Serv. 2d 867 (Okla. Ct. App. 1989). This time the distinguishing feature was the nature of the claim.

American Cyanamid. Concluding that the entry of summary judgment in favor of American Cyanamid was in error, the court of appeals held that failure to comply with U.C.C. section 2-607(3)(a) was not a defense to a claim for implied indemnity. There is language in the opinion suggesting that the court would not have been so willing to dispense with the need for notice had the case not been of the product liability type.<sup>135</sup> Even so, one must wonder whether the court's view conflicts with the policy underlying the notice requirement. What of the manufacturer against whom an indemnification claim is made and who wishes to fault the immediate seller for, perhaps, faulty installation? Might the ability to construct this defense be impaired by the failure to receive notice?<sup>136</sup>

Two cases raise the recurring issue of what, if any, burden of notice should be placed on the third-party beneficiary claimant. The first case is *Ratkovich v. Smithkline*.<sup>137</sup> The district court, relying on cases construing U.C.C. section 2-607(3)(a),<sup>138</sup> held that the statutory forerunner to the Code (the Illinois Sales Act) required a non-buyer to notify the manufacturer. Hence, the plaintiff's warranty claim against Smithkline (the manufacturer) for brain damage she suffered in utero when her mother took the drug Dexadrine was barred. The second case is *Ragland Mills, Inc. v. General Motors Corp.*<sup>139</sup> In that case, the Missouri Court of Appeals gives U.C.C. section 2-607(3)(a) a different reading. In its opinion, a buyer is only obligated to give notice to its immediate seller.<sup>140</sup> The problem with this approach is that it is premised on the questionable assumption that each buyer in the chain of distribution will notify its immediate seller. This may not occur when, for example, the end user skips the middlemen and sues the manufacturer directly or if the view that notice is not required in order to preserve the right to indemnity is accepted.

Finally, one topic which continues to receive judicial attention relates to the intermesh between a buyer's right to revoke acceptance and a seller's right to cure. Because U.C.C. section 2-508 refers only to rejection, a majority of courts have held that there is no right to cure when a buyer justifiably revokes.<sup>141</sup> With its decision in *City National Bank of Charleston v. Wells*,<sup>142</sup> the West Virginia

135. See *id.* at 1120, 11 U.C.C. Rep. Serv. 2d at 869 ("We decline to hold a third party plaintiff in such a suit to the 'reasonable notice' requirements provided by the U.C.C. for *commercial settings*"). (Emphasis added.)

136. For this reason there is authority that the characterization of the claim as one for indemnity does not excuse notice. See, e.g., *Firestone Tire & Rubber Co. v. Cannon*, 53 Md. App. 106, 452 A.2d 192 (1982), *aff'd*, 295 Md. 528, 456 A.2d 930 (1983).

137. 711 F. Supp. 436, 9 U.C.C. Rep. Serv. 2d 118 (N.D. Ill. 1989).

138. In particular, the court relied on *Berry v. G.D. Searle & Co.*, 56 Ill. 2d 548, 309 N.E.2d 550, 14 U.C.C. Rep. Serv. 346 (1974). See also U.C.C. § 2-607, Official Comment 5 ("the reason of the section does extend to requiring the beneficiary to notify the seller that an injury has occurred").

139. 763 S.W.2d 357, 9 U.C.C. Rep. Serv. 2d 893 (Mo. Ct. App. 1989).

140. Notice that unlike the plaintiff in *Ratkovich*, the plaintiff in *Ragland* had purchased from someone. Thus, upstream notice to the manufacturer is more of a possibility in the latter case than in the former.

141. See, e.g., *Bonebrake v. Cox*, 499 F.2d 951, 14 U.C.C. Rep. Serv. 1318 (8th Cir. 1974); *Gappelberg v. Landrum*, 666 S.W.2d 88 (Tex. 1984).

142. 384 S.E.2d 374, 10 U.C.C. Rep. Serv. 2d 798 (W. Va. Ct. App. 1989).

Supreme Court of Appeals seemingly joins this majority.<sup>143</sup> Although no explicit right of cure is given, it could be argued that whatever cure rights exist under U.C.C. section 2-508(1) are implicitly available to the seller under U.C.C. section 2-608(3).<sup>144</sup> The seller also should have the right to cure under U.C.C. section 2-508(2), although presently there is no statutory support for such a result.<sup>145</sup>

## REPUDIATION

The decision in *Neptune Research & Development, Inc. v. Teknics Industrial Systems, Inc.*<sup>146</sup> appears to point out very strongly the need to proceed cautiously when looking to non-Code law as a source of guidance for informed decisionmaking under the Code. The buyer in that case ordered a precision drill from the seller to be delivered sometime during mid-June of 1986; there was no "time-of-the-essence" clause in the contract. After the contract was negotiated, the seller discovered a design defect in the drill and took steps to correct it. When the buyer tried to establish a delivery date in early June, the seller hedged. Eventually, the buyer became impatient and visited the seller's shop in late August; at this time the drill was still being assembled. Although the redesigned drill was missing a "linear ballbearing raise" the buyer agreed to take it anyway and the parties agreed to a September 5 delivery date. When the buyer called on September 4 to confirm delivery, the seller indicated an inability to deliver until the 9th or 10th. The buyer then cancelled the contract and refused seller's offer later that day to deliver on September 5 as previously agreed. On these facts, the trial court found that the buyer had properly cancelled and was entitled to the return of its deposit.

On appeal, the New Jersey Superior Court affirmed. The court declined to accept the trial court's view that the failure to deliver in mid-June constituted a repudiation because "there was nothing in the surrounding circumstances to indicate that the initial time of performance was essential."<sup>147</sup> However, the buyer's agreement to accept the redesigned drill was predicated upon the

143. The court hedges a bit when it says "[t]his is especially true where, as here, the seller has previously been given the opportunity to correct the defect and has either failed or refused to do so." *Id.* at 381, 10 U.C.C. Rep. Serv. 2d at 805. The court does recognize an implied right to cure under limited circumstances by virtue of U.C.C. section 2-608(1)(a) (revocation may be permitted if the goods were accepted "on the reasonable assumption that [the] nonconformity would be cured and it has not been seasonably cured").

144. Under U.C.C. section 2-608(3) "[a] buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them." The Article 2 Study Group has recommended that the right to cure be explicitly extended to revocation situations. *See* Prelim. Rpt., Part 5, Rec. A2.5(5)(A); *Id.* Part 6, Rec. A2.6(6)(B).

145. The Article 2 Study Group split on this question. *See* Prelim. Rpt., Part 5, Rec. A2.5(5)(B).

146. 235 N.J. Super. 522, 563 A.2d 465, 10 U.C.C. Rep. Serv. 2d 107 (1989).

147. *Id.* at 531, 563 A.2d at 470, 10 U.C.C. Rep. Serv. 2d at 113. Because the failure to deliver in mid-June does not involve "a performance not yet due," U.C.C. section 2-610, it would seem more appropriate to refer to it in terms of "current breach" rather than "anticipatory repudiation."

“express condition that the seller have the product available by September 5.”<sup>148</sup> Now, according to the court, time was of the essence and the seller’s statement that the drill would not be available on the promised date was a repudiation under U.C.C. section 2-610.<sup>149</sup> The court then turned to the issue of whether the seller had effectively retracted its repudiation. Relying primarily on the express language of U.C.C. section 2-611(1),<sup>150</sup> the court held that cancellation barred a subsequent retraction even in the absence of prejudice.<sup>151</sup>

The analytical mistake made by the court was to assume a unity of contract doctrine which does not exist. Although the time for performance is not normally of the essence under most contracts, the rule has always been different where the contract calls for the delivery of goods.<sup>152</sup> Things are no different under the Code: a delayed delivery would normally justify rejection under U.C.C. section 2-601.<sup>153</sup> Therefore, notwithstanding the court’s conclusion to the contrary, the seller’s failure to deliver in mid-June was a material breach

148. *Id.* at 532, 563 A.2d at 471, 10 U.C.C. Rep. Serv. 2d at 114.

149. The court, seeing no substantive difference between the “substantially impair” standard of U.C.C. section 2-610 and the “materiality” standard of the Restatement (Second) of Contracts section 241, relied heavily on the latter. Section 241 provides:

In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standard of good faith and fair dealing.

The court considered the statement on September 4 in light of the totality of circumstances surrounding the transaction, including the seller’s failure to call the buyer on September 3 as promised.

150. U.C.C. section 2-611(1) reads as follows:

Until the repudiating party’s next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

151. Also addressed by the court was the seller’s vague contention that it had the right to cure under U.C.C. section 2-508(1). The court pointed out that the language of the section limits its applicability to situations where there has been rejection following a nonconforming tender or delivery. Here, the contract had been cancelled before there was any attempt made to deliver.

152. *See, e.g.,* *Norrington v. Wright*, 115 U.S. 188 (1885); *Oshinsky v. Lorraine Mfg. Co.*, 187 F. 120 (2d Cir. 1911).

153. The “perfect tender” rule of U.C.C. section 2-601 permits rejection “if the goods or tender of delivery fail in any respect to conform to the contract. . . .” However, a court should be able to use the general obligation of good faith, *see* U.C.C. section 1-203, to frustrate a buyer who rejects in bad faith.

and did give the buyer the right to cancel.<sup>154</sup> What was not explored by the court is the problematic relationship between section 2-610 and section 2-601. If delivery of the drill on September 9 rather than September 5 would not have “substantially impair[ed] the value of the contract to the [buyer]”<sup>155</sup> then the statement on September 4 would not have amounted to a repudiation. Yet, when the drill was delivered on September 9 the buyer could have rejected it. It could be that in this context, the contribution of U.C.C. section 2-610 is less important than it seems.<sup>156</sup>

## **REJECTION AND REVOCATION OF ACCEPTANCE**

As in past years, a number of courts are again struggling with the issue of whether a remote buyer should be afforded a right of revocation as against a remote seller. Because the remedy is generally considered to be available only against the immediate seller,<sup>157</sup> the cases invariably involve attempts to resist this conclusion by buyers who emphasize the somewhat different factual settings of their cases. In *Alberti v. Manufactured Homes, Inc.*,<sup>158</sup> the buyers were assured by the seller’s salesman that the floor of their new mobile home was constructed with a new material called “Novadeck.” The salesman based this representation on what he was told by the manufacturer’s salesman. When the home developed a leak which damaged the floor, the buyers learned from the manufacturer’s service representative that it was made of ordinary particle board. The trial court held that revocation was available against the manufacturer. On appeal, the North Carolina Court of Appeals reversed. It held that neither the statements made by the manufacturer’s representative to the seller’s salesman nor the visits to the home by the manufacturer’s service representative created the requisite contractual relationship between the buyers and the manufacturer. But what of the argument that privity was not necessary because the manufacturer had made an express warranty directly to the buyers?<sup>159</sup>

154. Although the remedy of cancellation was lost when the contract was modified in late August (the trial court was unsure whether a new or amended contract was created), the buyer might have retained the right to recover damages on account of the delay. The answer would depend on a more accurate characterization of the facts which, in turn, would make it possible to know which Code sections were applicable. See U.C.C. §§ 1-207 (“performance or acceptance under reservation of rights”); 2-209 (“modification, rescission and waiver”); 2-720 (“effect of ‘cancellation’ or ‘rescission’ on claims for antecedent breach”).

155. U.C.C. § 2-610.

156. Notwithstanding the absence of a repudiation, the buyer could, nonetheless, proceed to make alternative arrangements knowing that it could later cancel if and when the good was eventually tendered.

157. The view is premised on the words “the seller” which appear twice in U.C.C. section 2-608. Under U.C.C. section 2-608(1), the buyer may revoke acceptance of substantially nonconforming goods if, among other things, “the seller’s assurances induced the buyer’s acceptance.” Further, revocation is not effective until the buyer notifies “the seller” of it. U.C.C. § 2-608(2).

158. 94 N.C. App. 754, 381 S.E.2d 478, 10 U.C.C. Rep. Serv. 2d 1253 (1989).

159. At the time they purchased the home, the buyers received a 365-day manufacturer’s limited warranty covering defects in material and workmanship. Revocation has been permitted against a manufacturer that has expressly warranted the goods to the ultimate buyer. See, e.g., *Durfee v. Rod*



Because it had not been submitted to the jury and not properly raised on appeal, it was not considered by the court.

The issue of a direct manufacturer's warranty was, however, before the court in *Gochey v. Bombardier, Inc.*<sup>160</sup> In this case, the buyer of a defective snowmobile received at the time of purchase an express limited warranty from the manufacturer pursuant to which it covenanted to repair or replace defective components, materials or workmanship without charge. The trial court permitted revocation on the theory that the snowmobile dealer was the manufacturer's agent. On appeal, the Supreme Court of Vermont agreed that revocation against the manufacturer was proper, but for a different reason. The court held that a direct contract with the buyer was created when the manufacturer's warranty was passed on by the dealer.<sup>161</sup>

Another way to resist application of the general proscription against revocation by a non-privity buyer is demonstrated by *Smith v. Navistar International Transportation Corp.*<sup>162</sup> In *Smith*, the defective item was a semi-tractor truck manufactured by Navistar and financed through Navistar Financial Corp. ("Navistar Financial"). After notifying the dealer, Navistar, and Navistar Financial that he was revoking his acceptance, the buyer brought suit against the three, seeking damages from the dealer and Navistar.<sup>163</sup> Navistar Financial then moved for summary judgment on its counterclaim for unpaid installments and possession of the truck. While acknowledging that ordinarily revocation is not effective against the party financing the sale, the court denied judgment because the facts appeared to bring the situation squarely within the "close connection doctrine."<sup>164</sup> Here, Navistar and Navistar Financial were members

Baxter Imports, Inc., 262 N.W.2d 349, 22 U.C.C. Rep. Serv. 945 (Minn. 1977); Volkswagen of America, Inc. v. Novak, 418 So. 2d 801, 34 U.C.C. Rep. Serv. 1150 (Miss. 1982); Ventura v. Ford Motor Corp., 180 N.J. Super. 45, 433 A.2d 801, 32 U.C.C. Rep. Serv. 57 (1981).

160. 572 A.2d 921, 11 U.C.C. Rep. Serv. 2d 870 (Vt. 1990). Since the suit was brought under the Magnuson-Moss Warranty Act, 15 U.S.C.A. §§ 2301-2312 (West 1982), the court had to decide whether revocation was an available remedy for breach of a *limited* warranty. The court reasoned that because the Act makes no provision for remedies and section 2311(b)(1) preserves "any right or remedy of any consumer under State law or any other Federal law," revocation under U.C.C. section 2-608 was not precluded.

161. Referring to its recent decision in *Costa v. Volkswagen of America, Inc.*, 150 Vt. 213, 551 A.2d 1196, 8 U.C.C. Rep. Serv. 2d 389 (1988), the court noted that the case was being overruled to the extent it implied that revocation was not available against the manufacturer absent an agency relationship.

162. 714 F. Supp. 303, 10 U.C.C. Rep. Serv. 2d 790 (N.D. Ill. 1989).

163. No mention is made of the nature of the relief sought from Navistar Financial. Presumably, the buyer was asking to have the installment contract cancelled and the paid installments returned.

164. According to the court, "a buyer who obtains financing through an entity closely connected to the seller may use the seller's breach of its duties to the buyer as a defense to liability under the financing instrument." 714 F. Supp. at 309, 10 U.C.C. Rep. Serv. 2d at 797. However, the court's characterization of the buyer's defense as "revocation" suggests that the close connection doctrine was being used to accommodate more than just a defense; it would also support the buyer's affirmative claim to recover all payments previously made.

of the same corporate family and the loan contract had been approved by a Navistar dealer.<sup>165</sup>

A final case involving the right to revoke against one other than the immediate seller is *Hart Honey Co. v. Cudworth*.<sup>166</sup> Hart Honey purchased "supers" (wooden frames which are stacked to form beehives) from Cudworth. Unknown to Hart Honey, Cudworth had previously agreed to allow Bracken Honey Bee Corporation ("Bracken Honey") perpetual use of this equipment for \$10,000. Cudworth retained title and the right to sell the supers at any time with the understanding that if they were sold, Cudworth would receive the first \$35,000 in proceeds and Bracken Honey the remainder. Consequently, a portion of the \$62,250 purchase price paid by Hart Honey went to Bracken Honey. The Supreme Court of North Dakota held that the right to use the equipment and share in the proceeds did not make Bracken Honey a seller for purposes of revocation or any other remedy.<sup>167</sup> Recognizing that Bracken Honey might qualify as a "person in the position of a seller," the court said that this status creates no liability for breach.<sup>168</sup>

The Supreme Court of West Virginia, in *Kesner v. Lancaster*,<sup>169</sup> discussed several questions relative to a buyer's right to revoke acceptance. First, it quite correctly rejected the seller's ludicrous contention that U.C.C. section 2-608 does not apply unless one of the parties is a merchant. Clearly, the scope of article 2 is defined by the subject matter of the transaction, not the status of the parties.<sup>170</sup> Next, the court examined the requirement that the non-conformity in the goods must substantially impair their value to the buyer. The seller argued that where, as here, the price paid for the tractor-loader was \$9,000 and the cost of repairs was estimated to be \$720 the defects were insubstantial as a matter of law. Applying a hybrid subjective/objective test,<sup>171</sup> the court decided that the

165. Although not explicitly addressed by the court, the buyer had the right to revoke against Navistar (the manufacturer) because of its breach of an express "repair and replace" warranty.

166. 446 N.W.2d 742, 10 U.C.C. Rep. Serv. 2d 405 (N.D. 1989).

167. Under U.C.C. section 2-103(1)(d) a "seller" is defined as "a person who sells or contracts to sell goods." A "sale" is "the passing of title from the seller to the buyer for a price." U.C.C. § 2-106(1). Actually, the facts indicate that the supers were never accepted by Hart Honey. If that were true (it would make no substantive difference if it were) then the appropriate remedy would be rejection, not revocation.

168. U.C.C. section 2-707 gives a "person in the position of a seller" the right to withhold or stop delivery, resell, and recover incidental damages. As the court points out, it "does not create an additional category of 'sellers' who will be liable to the buyer upon breach of the contract." 446 N.W.2d at 744, 10 U.C.C. Rep. Serv. 2d at 409.

169. 378 S.E.2d 649, 9 U.C.C. Rep. Serv. 2d 122 (W. Va. 1989).

170. See U.C.C. section 2-102 ("Unless the context otherwise requires, this Article applies to transactions in goods. . .").

171. The court explained the test as follows:

This section . . . creates a subjective test in the sense that the needs and circumstances of the particular buyer must be examined. This determination is not, however, made by reference to the buyer's personal belief as to the reduced value of the goods in question. The trier of fact must make an objective determination that the value of the goods to the buyer has in fact been substantially impaired.

jury's determination that the value of the loader, which was inoperable and needed major repairs, had been substantially impaired was not clearly erroneous. The court also felt there was sufficient evidence for the jury to decide that the non-conformity could not reasonably have been discovered prior to acceptance. It noted that unless a defect is reasonably apparent or the buyer has some special expertise, a buyer who has made a reasonable inspection of goods and failed to find the defect has satisfied the "difficulty of discovery" text.<sup>172</sup>

Every year brings decisions considering whether the buyer's right of revocation is defeated by the continued use of the goods. In *Triad Systems Corp. v. Alsip*,<sup>173</sup> the Tenth Circuit held that post-revocation use of a computer system did not as a matter of law bar revocation. The question for the jury was whether the use was reasonable. The court in *Steers Security, Inc. v. Sportscoach Corp. of America*<sup>174</sup> adopted a similar approach when the problem arose because of the buyer's post-revocation use of a motorhome. In the court's view, reacceptance occurs only if the continued use is inconsistent with the seller's ownership. Because an isolated instance of use is not necessarily inconsistent with the seller's ownership, it could not be said as a matter of law that the buyer reaccepted the home when he used it to transport his daughter to the hospital.

Overall, the result in these two cases seems fair. It is likely, however, that perceptions of the reasonableness of the use will to some extent be influenced by whether the buyer is obligated to compensate the seller for the value of that use.<sup>175</sup>

Last year we asked the question whether the delivery of conforming goods to the buyer necessarily entitles the seller to the purchase price.<sup>176</sup> The answer then was no, this year it is yes. In *Lipsey Motors v. Karp Motors, Inc.*,<sup>177</sup> Lipsey purchased three cars from Karp. Lipsey anticipated selling the cars and using the proceeds to pay Karp. After two of the cars sat on Lipsey's lot for approximately four months, Mr. Lipsey apparently concluded that they could not be sold and returned them to Karp. The court of appeals held that notwithstanding their rejection, Karp could recover the price of the cars. In so doing, it misread U.C.C. section 2-703. Although the section is applicable to

172. 378 S.E.2d at 655, 9 U.C.C. Rep. Serv. 2d at 131. The buyer noted that the machine had been freshly painted, the undercarriage was in good condition, and the engine ran well. It was not until the machine stopped running, and the buyer removed the seats, floorboard, and belly pan that the defects were discovered. The court also pointed to U.C.C. section 2-608(1)(b) and indicated that the seller's assurances prior to acceptance that the machine was in "fine shape" might have absolved the buyer from a duty of inspection.

173. 880 F.2d 247, 9 U.C.C. Rep. Serv. 2d 567 (10th Cir. 1989).

174. 99 Or. App. 363, 781 P.2d 1267, 10 U.C.C. Rep. Serv. 2d 788 (1989).

175. Not all courts have read the Code as supporting an award of compensation to the seller for the value of the buyer's use of the goods prior to their return to the seller. See, e.g., *Barco Auto Leasing Corp. v. House*, 202 Conn. 106, 520 A.2d 162, 3 U.C.C. Rep. Serv. 2d 122 (1987).

176. See Frisch & Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title*, 45 Bus. Law. 2289, 2311-13 (1990) (discussing *Integrated Circuits Unlimited v. E. F. Johnson Co.*, 8 U.C.C. Rep. Serv. 2d 695 (2d Cir. 1989)).

177. 194 Ga. App. 15, 389 S.E.2d 537, 11 U.C.C. Rep. Serv. 2d 799 (1989).

wrongful rejections,<sup>178</sup> it recognizes the right to recover the price only “in a proper case” under U.C.C. section 2-709.<sup>179</sup> The court never decided whether this was such a case.<sup>180</sup> Yet, the court reached the correct result. Clearly having accepted the cars, Lipsey could no longer effectively reject. Rather, his attempt was to revoke which, if substantively wrongful, is always ineffective.<sup>181</sup>

## RECLAMATION

If the past year is any indication, the number of reported cases involving reclamation issues appears to be on the wane, and of those that were decided, most involved little that was new or of particular interest. In addition to the occasional seller who needs to be told that the right to reclaim under U.C.C. section 2-702 depends upon simultaneous compliance with Bankruptcy Code section 546(c),<sup>182</sup> we continue to be treated to the dubious conclusion that section 546(c) authorizes substitution of an administrative expense claim or alternative lien for the claim of a right of reclamation which is subordinate to the interest of a secured party (as a good faith purchaser) in those same goods.<sup>183</sup> However, one case, *Conoco, Inc. v. Braniff, Inc. (In re Braniff, Inc.)*,<sup>184</sup> did involve unexplored issues of importance.

Before the court was Conoco’s demand to reclaim aviation fuel supplied to Braniff at the Dallas-Fort Worth and Kansas City airports.<sup>185</sup> Conoco was Braniff’s only supplier at Dallas-Fort Worth; it was one of Braniff’s four

178. See U.C.C. § 2-602(3) (“The seller’s rights with respect to goods wrongfully rejected are governed by the provisions of this Article on Seller’s remedies in general (section 2-703)”).

179. Specifically, U.C.C. section 2-703(e) provides that the aggrieved seller may “recover damages for non-acceptance (section 2-708) or in a proper case the price (section 2-709). . . .”

180. By focusing on the remedy of rejection, the court implicitly assumes that the cars were never accepted: an assumption which is patently at odds with the facts. Regardless of its correctness, this assumption eliminates the most common statutory basis for recovering the price. See U.C.C. § 2-709. The right to the price would therefore depend on the ability of Karp to resell the cars at a reasonable price. See U.C.C. § 2-709(1)(b). Interestingly, the court did find that Karp’s futile attempts to sell the cars after they had been returned supported the jury’s conclusion that reasonable steps were taken to mitigate damages.

181. See Frisch & Wladis, *supra* note 176, at 2311–13.

182. See *In re Dynamic Technologies Corp.*, 106 Bankr. 994, 11 U.C.C. Rep. Serv. 2d 68 (Bankr. D. Minn. 1989). While not all courts have held that 11 U.S.C.A. section 546(c) codifies an independent avoiding power, see, e.g., *Farmers Rice Milling Co. v. Hawkins (In re Bearhouse, Inc.)*, 84 Bankr. 552, 6 U.C.C. Rep. Serv. 2d 1124 (Bankr. W.D. Ark. 1988), the overwhelming majority have.

183. See *In re Roberts Hardware Co.*, 103 Bankr. 396, 10 U.C.C. Rep. Serv. 2d 130 (Bankr. N.D.N.Y. 1988). See also *In re Misco Supply Co.*, 42 U.C.C. Rep. Serv. 1662 (D. Kan. 1986). The consequence of these cases is that the seller obtains more than it would have had the buyer not gone into bankruptcy. The logic of this is difficult to grasp. Fortunately, there are cases to the contrary. See, e.g., *In re Lawrence Paperboard Corp.*, 52 Bankr. 907, 42 U.C.C. Rep. Serv. 185 (Bankr. D. Mass. 1985).

184. 11 U.C.C. Rep. Serv. 2d 519 (1990).

185. Conoco also had delivered fuel to several other airports but, because of an inability to establish the “identification and control” elements of its claim, it was forced to abandon its case for reclamation at trial.

suppliers at Kansas City. The fuel was delivered to each location through an interstate common carrier pipeline from which it was directed into "tank farm" storage facilities operated by Braniff's fueling agent, Ogden Allied Aviation Services ("Ogden"). The fuel which Conoco sought to reclaim was that which was delivered within the 10-day period preceding the demand and which exhausted the credit balance in Braniff's account for prepayment of fuel and established a balance due.<sup>186</sup>

First, the court dealt with Braniff's contention that the demand for reclamation was legally insufficient because it did not adequately identify what fuel Conoco sought to reclaim. Braniff argued that despite the fact that each shipment was described by bill of lading number, shipment date, net gallons, and product cost, it was not able to determine when and where deliveries were made and which shipments were paid for in advance until it received monthly statements from Conoco and Ogden. Bankruptcy judge Corcoran held that the notice was sufficient. Since Ogden was Braniff's agent, its ability to identify the fuel described in Conoco's notice was properly attributable to Braniff.

Next, after deciding that Braniff had the requisite control over the fuel in the tank farms, the court turned to the critical "identification" issue.<sup>187</sup> With respect to fungible, bulk petroleum products, such as jet fuel, the court pointed out that Conoco must at a minimum be able to trace into an identifiable mass containing only fuel of like grade and quality. As to the Dallas-Fort Worth shipment, that was all that was necessary where, at the time of the demand, there was a sufficient amount of fuel on hand to cover the shipment in question. As to the deliveries at Kansas City which were commingled with fuel delivered by Conoco's three other suppliers, Judge Corcoran adopted what he described as a "'first in, first out' theory of bulk fuel use."<sup>188</sup> Because Braniff's evidence did not reflect when and in what amounts the deliveries from other suppliers were made during the 10-day reclamation period, its claim was denied.

Finally, the court had to decide on the appropriate remedy where, as here, Braniff used all the fuel that it had on hand at Dallas-Fort Worth at the time of

186. Braniff was required by agreement to prepay each Wednesday for its estimated purchases of fuel during the following week. Thus, some of the fuel delivered during the reclamation period had been paid for in advance.

187. The court set out the following four-part test for reclamation:

1. the debtor was insolvent at the time the goods were delivered by the seller;
2. a written demand was made on the debtor within 10 days after the goods were delivered to the debtor;
3. the goods were identifiable at the time the demand was made; and
4. the goods were in the possession and control of the debtor at the time the demand was made.

11 U.C.C. Rep. Serv. 2d at 526.

188. *Id.* at 532.

the demand. The remedy chosen was an administrative claim equal in amount to the invoice price of the fuel.<sup>189</sup>

The easiest and safest comment to make on the case might be that it is analytically barren. While the case supports identifying goods by means of a tracing fiction, it does so without regard for the dual nature of the conflict involved. On the one hand, there is the conflict between two or more sellers seeking to reclaim goods that have become commingled. As between them, it might make sense to allocate their interests according to some fictional device such as a first in, first out or lowest intermediate balance rule.<sup>190</sup> On the other hand, there is the conflict between the seller and the pool of general creditors. Whether tracing should be permitted in this context is another matter entirely. At the very least, the court should have made some effort to establish whether applicable state law recognizes the right to trace under U.C.C. section 2-702. Interestingly, the Article 2 Study Group on a closely related issue has tentatively concluded (no reasons are given) that a reclaiming seller should not have a right to proceeds.<sup>191</sup>

## **BUYER'S MONEY REMEDIES AND THEIR LIMITATIONS**

The article 2 norm of freedom of contract is perhaps best expressed in Official Comment 1 to U.C.C. section 2-719 where the drafters stated that their intention was to leave the parties "free to shape their remedies to their particular requirements. . . ." Because of the bargaining position of well-leveraged sellers, it is not uncommon to find that a buyer has contractually surrendered the available remedies under the Code for the sole right to have the seller repair or replace the defective good or its parts.<sup>192</sup>

However, the drafters also believed that "it is of the very essence of a sales contract that at least minimum adequate remedies be available."<sup>193</sup> Thus, the

189. The court disagreed with Conoco that it was entitled to both an administrative claim and a lien. Judge Corcoran correctly pointed out that U.S.C.A. section 546(c)(2) provides for alternative not cumulative remedies. *See* 11 U.S.C.A. § 546(c)(2) (West 1979 & Supp. 1991).

190. Surprisingly, the court never even considered the lowest intermediate balance rule which, in a commercial analogue, is commonly employed by secured parties to artificially identify cash proceeds of collateral which have been deposited and commingled in a bank account. *See, e.g.,* C.O. Funk & Sons, Inc. v. Sullivan Equip., Inc., 89 Ill. 2d 27, 59 Ill. Dec. 85, 431 N.E.2d 370 (1982). *See also In re Halmar Distrib., Inc.*, 116 Bankr. 328 (Bankr. D. Mass. 1990) (court determines secured party's claim to commingled inventory on the basis of a rule analogous to the lowest intermediate balance rule).

191. *See* Preliminary Report, Rec. A2.7(2)(c)(6).

192. *See* U.C.C. § 2-719(1)(a). This section provides in part:

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, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts. . . .

193. U.C.C. § 2-719 Official Comment 1.

objective is to foster freedom of contract, but not to the extent that a party is deprived "of the substantial value of the bargain."<sup>194</sup> To this end, if a limited remedy has failed of its essential purpose, then the door is opened to the full range of Code remedies.<sup>195</sup> This year as in past annual surveys, most of the cases which alleged failure of essential purpose involve the limited remedy of repair or replacement. The conclusion that failure has occurred usually follows from an inability or unwillingness on the part of the seller to remedy the defects.<sup>196</sup> One case demonstrates that the scope of the inquiry should not be so limited. In *Reigel Power Corp. v. Voith Hydro*,<sup>197</sup> the plaintiffs' assignor purchased an electric turbine which went into operation in mid-1984. According to the plaintiffs, the turbine was inoperable for about half the time between 1984 and 1987 when it finally became operational. The Fourth Circuit, applying Delaware law, held that the considerable operation time lost during repairs did not, in and of itself, cause the repair or replacement remedy to fail of its essential purpose.<sup>198</sup> In so doing it emphasized the fact that the sale was a commercial sale of a complicated product.<sup>199</sup> To avoid the limitation, in this instance, the buyer would have to show that the seller refused or was unable to cure the problem.

Another case illustrates the wisdom of providing for a backup remedy in the event the limited remedy fails to accomplish its essential purpose. In *Ritchie Enterprises v. Honeywell Bull, Inc.*,<sup>200</sup> the contract for the sale of a computer provided that if the seller was unable to cure its defects, the seller would be liable for actual damages not to exceed the purchase price. Even though the seller was unable to get the computer to work properly, the district court concluded that the existence of an available backup remedy prevented the failure of the limited remedy. Thus, the court escaped the need to decide

194. *Id.*

195. *See id.* § 2-719(2) ("[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.").

196. Unfortunately, little guidance is offered as to when such a failure occurs, and as a result the caselaw is voluminous. Some recent cases include *Milgard Tempering, Inc. v. Selas Corp. of America*, 11 U.C.C. Rep. Serv. 2d 558 (9th Cir. 1990); *Great Dane Trailer Sales, Inc. v. Malvern Pulpwood, Inc.*, 301 Ark. 436, 785 S.W.2d 13, 11 U.C.C. Rep. Serv. 2d 875 (1990); *Liberty Truck Sales, Inc. v. Kimbrel*, 9 U.C.C. Rep. Serv. 2d 908 (Ala. 1989).

197. 888 F.2d 1043, 11 U.C.C. Rep. Serv. 2d 552 (4th Cir. 1989).

198. Actually, most of the court's opinion appears to be *dicta*. When the problems occurred the warranty period had expired.

199. The court said that

in determining whether the contract limitation fails of its essential purpose, the facts and circumstances surrounding the contract, the nature of the basic obligations of the party, the nature of the goods involved, the uniqueness or experimental nature of the items, the general availability of the items, and the good faith and reasonableness of the provisions are factors which should be considered.

888 F.2d at 1045, 11 U.C.C. Rep. Serv. 2d at 555 (quoting *J.A. Jones Const. Co. v. Dover*, 372 A.2d 1 (Del. 1977)).

200. 730 F. Supp. 1041, 11 U.C.C. Rep. Serv. 2d 1170 (D. Kans. 1990).

whether the contractual exclusion of consequential damages is vitiated by the failure of a limited remedy clause.

Given that the concept of negotiated allocation of risks is central to cases like these, both courts presumably reached the correct result. In *Voith Hydro*, it is reasonable to assume from the limited remedy clause that the buyer had implicitly assumed the risk of loss during the period needed to correct the defects in the turbine. Similarly in *Ritchie*, the court did little more than to give effect to the allocation of risks reflected by the specific terms of the parties' contract. However, it is not unusual for one of the parties to argue that the contractual risk allocation should not be honored because a basic assumption on which it was made turns out to have been incorrect. When parties agree, for example, to limit the buyer's remedy to repair or replacement and, by separate provision, to exclude the right to recover consequential damages, the assumption probably is that the seller will be willing and able to cure all defects. If it later turns out that the seller will not or cannot, should the exclusion of consequentials remain enforceable?

The caselaw is in such disarray that it is neither possible to predict how a court deciding this question for the first time will answer it, nor to foresee what, if any, analytical process will be employed. In *Milgard Tempering, Inc. v. Selas Corp. of America*,<sup>201</sup> the seller was unable after two and one-half years of trying to bring a horizontal batch tempering furnace up to contract specifications. Concluding that the limited repair remedy failed of its essential purpose, the court had to decide whether the consequential damages exclusion was thus invalidated. The Ninth Circuit predicted that Washington courts would take a case-by-case approach and determine if the two provisions are either "separable elements of risk allocation" or "inseparable parts of a unitary package of risk-allocation"<sup>202</sup> and if the latter, whether the seller's "default caused a loss which was not part of the bargained-for allocation of risk."<sup>203</sup> Influenced by the amount of the purchase price (\$1.45 million), the seller's original representations and its lengthy attempt at repair, the court agreed with the district court's decision to lift the cap on consequential damages.

Not all courts this year have based their decisions on a risk allocation analysis. Some have adopted what looks like an absolute rule that the exclusion of consequentials is<sup>204</sup> or is not invalidated.<sup>205</sup> Finally there are those cases which leave us unsure of the courts' actual thinking. For example, in *Canal*

201. 11 U.C.C. Rep. Serv. 2d 558 (9th Cir. 1990).

202. *Id.* at 563–64 (quoting *Fiorito Bros., Inc. v. Fruehauf Corp.*, 747 F.2d 1309, 1314–15 (9th Cir. 1984) (quoting district court)).

203. *Id.* at 565.

204. *See, e.g.*, *Ragen Corp. v. Kearney & Trecker Corp.*, 11 U.C.C. Rep. Serv. 2d 1058, 1067 (3d Cir. 1990) (under Wisconsin law "when the exclusive remedy fails . . . the buyer can proceed to any remedy available under the U.C.C. including consequential damages. . . .").

205. *See, e.g.*, *Riegel Power Corp. v. Voith Hydro*, 888 F.2d 1043, 1047, 11 U.C.C. Rep. Serv. 2d 552, 557 (4th Cir. 1989) (Although *dictum*, the court seemingly aligns itself with "the more recent cases [indicating] that the two provisions are independent and are to be applied as such").



*Electric Co. v. Westinghouse Electric Corp.*,<sup>206</sup> the Supreme Court of Massachusetts uses fairly strong language to make the point that the limitation of remedies and the exclusion of consequential damages are entirely separate provisions.<sup>207</sup> Yet, the court seemingly attaches some relevance to its observation that the equipment and parties were sophisticated and the seller acted neither wilfully nor in bad faith. How this court will dispose of future cases remains to be seen.

Despite several cases decided this survey period which presume conscionability in purely commercial transactions,<sup>208</sup> the number of decisions holding such limitations of liability to be ineffective in commercial cases continues to grow. In *Construction Associates, Inc. v. Fargo Water Equipment Co.*,<sup>209</sup> the plaintiff purchased from Fargo Water a large supply of polyvinyl chloride pipe manufactured by Johns-Manville Sales Corporation ("J-M"). The jury found that the pipe was defective and awarded plaintiff \$140,000 for expenses incurred in making repairs to a water supply line constructed with the pipe. The trial court ruled that the clause in the pipe installation guide which limited remedies and specifically excluded liability for consequential damages was unconscionable.

On appeal, the Supreme Court of North Dakota affirmed. In so doing, it analyzed the clause in terms of both procedural and substantive unconscionability.<sup>210</sup> The clause was procedurally unconscionable since the superior bargaining strength of J-M gave it the power to dictate a term which was not bargained for and was not brought to the plaintiff's attention until long after the sales contract had been finalized. The clause was substantively unconscionable because it left the plaintiff without an effective remedy.<sup>211</sup> Moreover, there was no way for the plaintiff to discover the defect prior to incurring substantial damages.

Perhaps the most interesting aspect of the case is obliquely referenced to by the court in a footnote.<sup>212</sup> The facts show that the plaintiff first learned that its

206. 406 Mass. 369, 10 U.C.C. Rep. Serv. 2d 664 (1990).

207. *See id.* at 375, 10 U.C.C. Rep. Serv. 2d at 669 ("The disclaimer of consequential damages is an entirely separate contractual provision from the limited repair or replacement remedy and thus survives the failure of the limited remedy").

208. *See, e.g., Veeder v. NC Mach. Co.*, 720 F. Supp. 847, 10 U.C.C. Rep. Serv. 2d 841 (W.D. Wash. 1989); *Arena, Estate of v. Abbott & Cobb, Inc.*, 551 N.Y.S.2d 715, 11 U.C.C. Rep. Serv. 2d 476 (N.Y. App. Div. 1990).

209. 446 N.W.2d 237, 10 U.C.C. Rep. Serv. 2d 821 (N.D. 1989).

210. "Courts and commentators have generally viewed the [C]ode's unconscionability provisions within a two-pronged framework: procedural unconscionability, which encompasses factors relating to unfair surprise, oppression, and inequality of bargaining power, and substantive unconscionability, which focuses upon the harshness or one-sidedness of the contractual provision in question." *Id.* at 241, 10 U.C.C. Rep. Serv. 2d at 826.

211. The limited remedy called for the replacement of defective pipe. However, the evidence showed that the accepted method of repair is not to replace pipe which has been laid, but to repair it with a stainless steel sleeve.

212. *See* 446 N.W.2d at 243 n.7, 10 U.C.C. Rep. Serv. 2d at 828 n.7. The court questions, but does not decide, whether a limitation of remedies or exclusion of damages must be part of the basis of the bargain of the contract in order to be enforceable.

remedies were being limited or excluded after the time of contracting. On what theory then does the clause become operative? Surely, the plaintiff never agreed to modify the contract so as to include the clause. To complicate matters further, let us not forget that the plaintiff was not in privity with J-M. It is presently uncertain to what extent a remote seller may assert remedy limitations when a non-privity plaintiff seeks recovery.<sup>213</sup>

A final group of cases in the limitation of liability area is worth mentioning. Unlike U.C.C. section 2-316(2) (warranty disclaimers), U.C.C. section 2-719(1) does not specifically state that limitation of liability clauses must be "conspicuous."

In *Stauffer Chemical Co. v. Curry*,<sup>214</sup> the Wyoming Supreme Court held that a disclaimer of implied warranties of merchantability and fitness, printed toward the bottom of an insecticide sack in type approximately one-half the size of type used to provide other information, was not conspicuous and therefore was not effective. The court then reviewed language on the sack limiting buyer's remedies to return of the product's purchase price. Although it agreed with the seller that U.C.C. section 2-719 did not specifically require conspicuousness, the court held that such a limitation is implicit in the statutory scheme. In reaching this conclusion, the court relied on various decisions on statutory construction to the effect that the Wyoming legislature could not have intended to treat such similar provisions differently. The two statutes (2-316 and 2-719) must be considered in *pari materia* to avoid the "absurd" result suggested by the seller.

The Georgia Court of Appeals addressed the same issue and reached the opposite result in *Apex Supply Co., Inc. v. Benbow Industries, Inc.*<sup>215</sup> In *Apex*, the trial court ruled that sales invoices disclaiming implied warranties for the construction of a greenhouse were ineffective under U.C.C. section 2-316 because they were not conspicuous. However, that court granted a wholesaler and a distributor's motion for JNOV on the issue whether recovery of incidental and consequential damages were barred by language limiting recovery to the purchase price. The court of appeals affirmed, stating that it is the mere existence of the limitation of remedies language in U.C.C. section 2-719, without regard to its "conspicuousness," that is controlling. In its analysis, the court noted that there was a fundamental difference between the effect of a total *disclaimer* of any implied warranties and the mere *limitation* of available remedies. The court remarked that legislative intent was that U.C.C. section

213. See *Spagnol Enter., Inc. v. Digital Equip. Corp.*, 568 A.2d 948, 11 U.C.C. Rep. Serv. 2d 49 (Pa. Super. Ct. 1990) (rights of a remote purchaser are unaffected by limitations of liability in the manufacturer's contract of sale). But see U.C.C. § 2-318 Official Comment 1 ("To the extent that the contract of sale contains provisions under which . . . remedies for breach are limited, such provisions are equally operative against beneficiaries of warranties under this section").

214. 778 P.2d 1083, 10 U.C.C. Rep. Serv. 2d 342 (Wyo. 1989).

215. 189 Ga. App. 598, 376 S.E.2d 694, 9 U.C.C. Rep. Serv. 2d 547 (1988). See also *Webster v. Sensormatic Electronic Corp.*, 193 Ga. App. 654, 389 S.E.2d 15, 11 U.C.C. Rep. Serv. 2d 499 (1989).

2-316 should have no bearing on the seller's ability to achieve the less comprehensive legal effect of limiting remedies under U.C.C. section 2-719. The issue of conspicuousness was "irrelevant."

The best resolution lies in cases which treat the conspicuous issue as part of a broad unconscionability analysis under the terms of U.C.C. section 2-719(3).<sup>216</sup> The court's role then is to determine whether the bargaining strength and commercial sophistication of the parties made it reasonable that the limiting language was brought to the parties' attention. Actual knowledge should not be necessary.

In other litigation, two courts have concluded that a new business is not necessarily foreclosed from recovering lost profits under U.C.C. section 2-715(2).<sup>217</sup> Although proving probable losses is no easy matter for a business without a track record, it may be possible to establish a sufficient factual basis for an award "with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like."<sup>218</sup> In another case, the Supreme Court of Arizona ruled that lost profits need not be specifically pleaded.<sup>219</sup> It was enough that the plaintiff (a feeder pig operation) alleged that its profitability is based on the number of pigs it brings to market and that the seed purchased from the defendant caused the death of some pigs.

## ***SELLER'S MONEY REMEDIES***

The Code spells out several different measures of damages potentially available to the aggrieved seller. Stripped to their common underlying policy, each one seeks to put the seller "in as good a position as if the other party had fully performed. . . ."<sup>220</sup> As in past annual surveys, there is no shortage of cases involving which measure, in light of the facts presented, best accomplishes this goal. Since the amount of recovery may be significantly affected depending on which measure is applied, the choice is understandably worth fighting for.

216. *See, e.g.*, *AMF, Inc. v. Computer Automation, Inc.*, 573 F. Supp. 924, 37 U.C.C. Rep. Serv. 1583 (S.D. Ohio 1983); *Office Supply Co. v. Basic/Four Corp.*, 538 F. Supp. 776, 34 U.C.C. Rep. Serv. 857 (E.D. Wis. 1982).

217. *See* *Milgard Tempering, Inc. v. Selas Corp. of America*, 11 U.C.C. Rep. Serv. 2d 558 (9th Cir. 1990); *AGF, Inc. v. Great Lakes Heat Treating Co.*, 51 Ohio St. 3d 177, 11 U.C.C. Rep. Serv. 2d 859 (1990).

218. *Great Lakes Heat Treating Co.*, 51 Ohio St. 3d at 181, 11 U.C.C. Rep. Serv. 2d at 865 (quoting Restatement (Second) of Contracts 146, § 352 Comment b (1981)). The plaintiff's proof was insufficient in *Great Lakes Heat Treating Co.*, but was sufficient in *Selas Corp.* although based primarily on the testimony of a single expert, some of whose figures the district court found "difficult to swallow." 11 U.C.C. Rep. Serv. 2d at 568.

219. *See* *Drew v. United Producers & Consumers Coop.*, 161 Ariz. 331, 9 U.C.C. Rep. Serv. 2d 523 (1989). ("The prayer for relief simply asks for damages, without specifying the type in an amount to be proven at trial. . . ."). *Id.* at 332, 9 U.C.C. Rep. Serv. 2d at 525.

220. U.C.C. § 1-106(1) ("The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed. . . .").

Three cases illustrate areas in which the choice made by the seller has been questioned.

The first and perhaps the most interesting case of the three is one which is not entirely within the transactional scope of article 2, *Rheinberg Kellerei GmbH v. Brookfield National Bank of Commerce*.<sup>221</sup> The buyer ordered a shipment of wine from Rheinberg through an importer, Frank Sutton & Co. ("Sutton"). Payment was to be made through an international letter of collection<sup>222</sup> which noted that payment was due "on arrival of goods in Houston harbor and called for the buyer's bank, Brookfield National Bank ("Brookfield") to notify Sutton "in case of any difficulty of lack [sic] payment." Although the wine did not arrive in Houston until March 31, Brookfield presented the letter of collection on March 27, at which time it was told by the buyer to hold the letter until financing could be arranged. Nothing further occurred until early May, when Brookfield cabled seller's bank for instructions after learning from Sutton that the wine was still at the Houston port. Unfortunately, by that time the wine had deteriorated completely. With the buyer out of business, Rheinberg brought this suit alleging that Brookfield had negligently failed to give notice of buyer's nonpayment. On these facts, the trial court entered judgment for Brookfield.<sup>223</sup>

On appeal, the Fifth Circuit reversed. With respect to the duty to give notice of the buyer's nonpayment, the court held that notice was required under both the letter of collection<sup>224</sup> and article 20(iii)(c) of the International Rules of Collection<sup>225</sup> even though at the time the letter was presented, payment had not yet come due because the wine had not arrived. Turning then to the issue of damages, the Fifth Circuit concluded that it was inappropriate to measure recovery under U.C.C. section 2-708(1).<sup>226</sup> In the court's view, the seller was entitled to the full contract price under U.C.C. section 2-709 because the wine

221. 901 F.2d 481, 11 U.C.C. Rep. Serv. 2d 1214 (5th Cir. 1990).

222. The letter was issued by the seller's bank and sent to the buyer's bank for presentment to the buyer. To receive the accompanying documents (bill of lading and invoices) and collect the goods, the buyer pays the amount due to its bank, which then forwards the funds to the seller's bank. The rights and responsibilities of the parties are governed by the ICC's International Rules for Collection. *Id.* at 482 n.2, 11 U.C.C. Rep. Serv. 2d at 1216 n.2.

223. The trial court concluded that Brookfield had no knowledge of the buyer's default because it had no notice that the wine had arrived and no duty to inquire further. *Id.* at 483, 11 U.C.C. Rep. Serv. 2d at 1216.

224. The court reasoned that, because the letter instructed Brookfield to notify Sutton "in case of any *difficulty* of lack [sic] payment," it should have given notice when the buyer told it of the need to obtain financing. *Id.* at 483, 11 U.C.C. Rep. Serv. 2d at 1217.

225. Article 20(iii)(c) states that the "collecting bank must send without delay advice of non-payment or advice of non-acceptance to the bank from whom the collection order was received." Looking to the Code for guidance, in particular, U.C.C. section 4-502, the court concluded that notice of nonpayment is required whether or not payment is then due. *Id.* at 483, 11 U.C.C. Rep. Serv. 2d at 1218.

226. U.C.C. section 2-708(1) establishes damages by computing the difference between the market price at the time and place for tender and the contract price. *Id.* at 484 n.8, U.C.C. Rep. Serv. 2d at 1219 n.8.

was damaged after the risk of loss had passed to the buyer.<sup>227</sup> The problem with the opinion is that the court neglected to mention that the seller's right to the price under U.C.C. section 2-709(1)(a) arises only if the loss occurs within a "commercially reasonable time."<sup>228</sup> Recall that the wine sat at the port for more than a month. The court should have discussed in the alternative, whether a cause of action for the price existed because the buyer had accepted the wine.<sup>229</sup> Thus, the opinion is not entirely persuasive.

The second case is *Bill's Coal Co., Inc. v. Board of Public Utilities of Springfield*.<sup>230</sup> Here the parties entered into a long-term coal requirements contract. Eventually the relationship deteriorated and lawsuits followed.<sup>231</sup> The Tenth Circuit was called upon to decide whether the sellers would be inadequately compensated under U.C.C. section 2-708(1), and consequently entitled to lost profits under U.C.C. section 2-708(2). Evidence presented at trial disclosed that during the contract period the sellers had difficulty meeting the buyer's needs. In fact, the sellers were forced to purchase coal from other suppliers because they had to close one of their two principal mines. Furthermore, the sellers' president admitted that they were able to sell to another customer only because the buyer refused to accept any more coal. On these facts, the Tenth Circuit affirmed, as not clearly erroneous,<sup>232</sup> the trial court's finding that the sellers were not lost volume sellers,<sup>233</sup> and thus U.C.C. section 2-708(1) was the proper measure of damages.<sup>234</sup>

Finally, consider *Tesoro Petroleum Corp. v. Holborn Oil Co., Ltd.*<sup>235</sup> Seller had purchased approximately 10 million gallons of gasoline at \$1.26 per gallon

227. The risk of loss had passed when the wine arrived in Houston and was available to be picked up by the buyer. See U.C.C. § 2-509(1)(b).

228. The full text of U.C.C. section 2-709(1)(a) reads as follows:

(1) when the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price  
(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer. . . .

229. For what constitutes acceptance, see U.C.C. section 2-606.

230. 9 U.C.C. Rep. Serv. 2d 1238 (10th Cir. 1989).

231. The complete procedural history of the case can be found in *Bill's Coal Co. v. Board of Public Util.*, 682 F.2d 883, 34 U.C.C. Rep. Serv. 166 (10th Cir. 1982), *cert. denied*, 459 U.S. 1171 (1983).

232. The court pointed out that whether a seller qualifies as a lost volume seller "is a decision dictated by the underlying facts and thus ultimately a question of fact reviewed under the clearly erroneous standard." 9 U.C.C. Rep. Serv. 2d at 1242.

233. The court's definition of a "lost volume seller" was "one who has the capacity to perform the contract which was breached as well as other potential contracts, due to their unlimited resources or production capacity." *Id.* Other courts have expanded this definition to reflect what they perceive to be economic reality. They would shift the emphasis from the seller's capacity to perform other contracts to whether it would have been profitable to do so. See, e.g., *R.E. Davis Chem. Corp. v. Disonics, Inc.*, 826 F.2d 678, 4 U.C.C. Rep. Serv. 2d 369 (7th Cir. 1987).

234. Additionally, the court held that litigation costs and accounting fees were not recoverable items of incidental damages under U.C.C. section 2-710. 9 U.C.C. Rep. Serv. 2d at 1243.

235. 547 N.Y.S.2d 1012, 10 U.C.C. Rep. Serv. 2d 814 (N.Y. App. Div. 1989).

and alleged a contract with the defendant-buyer to sell at a price of \$1.30 a gallon. When the market price suddenly dropped to about \$.80 per gallon the buyer refused delivery and the seller resold to a third party for a price of \$1.10 per gallon.<sup>236</sup> The sole issue before the court on cross-motions for partial summary judgment was whether the measure of damages should be governed by U.C.C. section 2-706<sup>237</sup> or U.C.C. section 2-708(1). The seller argued that it was entitled to recover damages of \$.50 per gallon (the difference between contract price and market price at the time of tender). The seller maintained that this figure would give it the \$.34 per gallon total profit it would have earned had the buyer not breached. The seller's calculations added to the \$.04 per gallon expected profit on the contract with the buyer (difference between purchase price of \$1.26 and contract price of \$1.30), the \$.30 per gallon profit that would have been earned on the sale to the third party (difference between purchase price of \$.80 paid on the open market and contract price of \$1.10). The buyer, on the other hand asserted that damages should be limited to \$.20 per gallon, representing the difference between the contract price and the resale price.

Adopting the view of Professors White and Summers,<sup>238</sup> the court held that U.C.C. section 2-703<sup>239</sup> does not give an aggrieved seller the unfettered right to choose between U.C.C. section 2-706 and U.C.C. section 2-708. To ignore the resale in this case would, in the court's opinion, result in an unforeseen windfall due solely to variations in market prices. The court was correct. The seller's position arguably makes sense, but only if the sale to the third party would have been made irrespective of the buyer's breach.<sup>240</sup> The court was careful to make the point that the facts indicated otherwise.<sup>241</sup>

Notice that if the seller in *Tesoro Petroleum* had been successful in its bid to recover under U.C.C. section 2-708, it would have accomplished the often difficult task of receiving compensation for consequential losses (the lost opportunity to earn a greater profit on the sale to the third party). The difficulty lies in the fact that the Code does not expressly recognize a seller's right to recover

236. No explanation is offered as to why the third party was willing to pay a premium (about 40% above market price) for the gasoline.

237. The measure of damages under U.C.C. section 2-706 is the difference between the resale price and the contract price.

238. See J. White & R. Summers, Uniform Commercial Code 354-56 (3d ed. 1988).

239. U.C.C. section 2-703 provides that if a "buyer wrongfully rejects or revokes acceptance of the goods, . . . then with respect to any goods directly affected . . . , the aggrieved seller may . . . (d) resell and recover damages as hereafter provided (section 2-706); [or] (e) recover damages for non-acceptance (section 2-708). . . ."

240. In such a case it could not be said that the second sale was "reasonably identified as referring to the broken contract. . . ." U.C.C. § 2-706(2).

241. See 547 N.Y.S.2d 1017, 10 U.C.C. Rep. Serv. 2d 820 (N.Y. App. Div. 1989) ("The statement in plaintiff's reply memorandum of law . . . that 'in all likelihood, (plaintiff) would have negotiated such a sale [to the third party] even in the absence of (defendant's) breach' is not supported by any facts in the record. . . .").

consequential damages.<sup>242</sup> The recent case of *Florida Mining & Materials Corp. v. Standard Gypsum Corp.*<sup>243</sup> considered this issue. Although the opinion is silent as to the precise items of damages involved, they were clearly characterized as consequential by the court. As such, the court of appeals summarily denied recovery. If a court is unwilling to expressly recognize such a recovery despite the Code's silence<sup>244</sup> there are alternative methods of accomplishing the same result. Probably the most obvious is to argue that the loss falls under the heading of incidental damages.<sup>245</sup> Recovery may also be possible if the "lost profit" language of U.C.C. section 2-708(2) is liberally applied.<sup>246</sup>

## STATUTES OF LIMITATIONS

Much of the tension in this area is directly attributable to 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).<sup>247</sup> Three cases illustrate situations where there is a serious risk to the buyer that a breach of warranty action will be barred before the breach is actually discovered.

The first of the three, *Rosen v. Spanierman*,<sup>248</sup> presents a scenario likely to appear with some frequency as owners of artwork and other collectibles seek to cash in on a "hot" market, only later to learn, much to their chagrin, that what they own is not the real thing.<sup>249</sup> Some 20 years after paying \$15,000 to the IRA Spanierman Gallery for what they thought was an original painting by John Singer Sargent, the plaintiffs were told that it was not authentic and not worth the approximate \$200,000 for which it had been appraised. On Spanierman's motion for summary judgment, the district court ruled that the limitations period had run on the warranty claim and that plaintiffs had failed to state a cause of action for fraud.<sup>250</sup>

242. U.C.C. section 2-715 only addresses the buyer's right to incidental and consequential damages.

243. 9 U.C.C. Rep. Serv. 2d 1245 (Fla. Dist. Ct. App. 1989).

244. To deny the seller, in all cases, the recovery of consequentials would seem to run counter to the remedial policy expressed in U.C.C. section 1-106. The Article 2 Study Group has concluded that a seller should be able to recover consequential damages. See Article 2 Study Group, Prelim. Rpt., Part 7, Rec. A2.7(8) (Mar. 1, 1990).

245. Incidental damages are recoverable under U.C.C. section 2-710.

246. See, e.g., *Rogerson Aircraft Corp. v. Fairchild Indus.*, 632 F. Supp. 1494, 1 U.C.C. Rep. Serv. 2d 1512 (C.D. Cal. 1986).

247. Interestingly, the Article 2 Study Group was unable to reach any conclusions about U.C.C. section 2-725. See Article 2 Study Group, Prelim. Rpt., Part 7 (Mar. 1, 1990).

248. 10 U.C.C. Rep. Serv. 2d 846 (2nd Cir. 1990).

249. This is not the first time that a case of this type has appeared in the annual survey. See Frisch & Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title*, 43 Bus. Law. 1259, 1302 (1988) (discussing *Firestone & Parson, Inc. v. Union League*, 3 U.C.C. Rep. Serv. 2d 449 (E.D. Pa. 1987)); Frisch & Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title*, 44 Bus. Law. 1445, 1491-92 (1989) (discussing *Wilson v. Hammer Holdings, Inc.*, 850 F.2d 3, 6 U.C.C. Rep. Serv. 2d 321 (1st Cir. 1988)).

250. Plaintiff Frances Lipman had purchased the painting (provided the funds) as a gift for plaintiffs Hobart and Norma Rosen. However, it was actually Hobart Rosen who negotiated with

On appeal, the Second Circuit approved of the trial court's disposition of the warranty claim. Willing to concede for the sake of argument that a painting "performs" for purposes of U.C.C. section 2-725, the court rejected the notion that the express warranty of authenticity was the equivalent of a "future performance" warranty.<sup>251</sup> Moreover, because the forgery could have been detected at the time the painting was purchased, the situation was not one where discovery of the breach "must await" future performance. All, however, was not necessarily lost. The court went on to hold that although two of the plaintiffs did not technically qualify as buyers, their allegations were sufficient to state a separate and distinct claim of common law fraud.<sup>252</sup>

The second case, *Huff v. Hobgood*,<sup>253</sup> involved a claim for breach of the warranty of good title.<sup>254</sup> Huff purchased a used bulldozer from Hobgood in 1978 and later sold it to Smith in 1983. As things turned out, the bulldozer had been stolen and, as a result, Smith was forced to repurchase it from the true owner's insurance company. After reimbursing Smith for his losses, Huff sought recovery from Hobgood. The Supreme Court of Mississippi affirmed the grant of summary judgment for Hobgood. The court, while acknowledging that warranty of title cases are rare, saw no reason to treat them differently from the more familiar cases involving the warranties of merchantability or fitness for a particular purpose. Unfortunately for Huff, this meant that the limitations period began to run in 1978 when the bulldozer was tendered.<sup>255</sup>

The third case is *American Alloy Steel, Inc. v. Armco, Inc.*<sup>256</sup> In contrast to the indemnification claim in *Huff*, which was factually atypical, the claim in *Armco* was commonplace. American Alloy purchased steel plating from Armco

the defendant. As a result, the district court felt that there had been no detrimental reliance by the Rosens and no misrepresentations made to Frances Lipman. 10 U.C.C. Rep. Serv. 2d at 853.

251. U.C.C. section 2-725(2) adopts a date-of-discovery rule "where a warranty explicitly extends to future performance . . . and discovery of the breach must await the time of such performance. . . ." The actual warranty, which appeared on the seller's invoice, stated: "[t]his picture is fully guaranteed by the undersigned to be an original work by John Singer Sargent." 10 U.C.C. Rep. Serv. 2d at 848.

The court declined to accept plaintiffs' argument that the permanent quality of authenticity compelled a finding that the warranty extended to the future or the argument that New York law recognizes an explicitly future warranty when the good by its nature will perform over a period of time. 10 U.C.C. Rep. Serv. 2d at 850-51.

252. In deciding the way it did, the court was careful to emphasize the unusual circumstances of the case. Only because the Rosens were permitted to select their gift were they able allege the requisite detrimental reliance, *i.e.*, if they had known the truth a different, more valuable item would have been chosen. 10 U.C.C. Rep. Serv. 2d at 853-56.

253. 549 So. 2d 951, 10 U.C.C. Rep. Serv. 2d 856 (Miss. 1989).

254. In addition to the implied warranty of title, see U.C.C. § 2-312, an express warranty was given. The relevant contract language stated that: "[t]he said property I guarantee is my own and free of all claims and offsets of any and all kinds." 549 So. 2d at 952, 10 U.C.C. Rep. Serv. 2d at 857.

255. It should be noted that Mississippi version U.C.C. section 2-725 provides for a six-year limitations period, rather than the four-year period in the Official Text. Miss. Code Ann. § 75-2-725 (1972).

256. 777 S.W.2d 173, 10 U.C.C. Rep. Serv. 2d 861 (Tex. Ct. App. 1989).



which was delivered to American Alloy's warehouse for storage pending resale to ultimate end users. More than four years later it was sold to Swecomex. When it was discovered that the steel was defective, American Alloy replaced it and filed suit against Armco.<sup>257</sup> One by one the Texas Court of Appeals considered and rejected the various attempts of American Alloy to escape the stricture of U.C.C. section 2-725. According to the court there was no future performance warranty;<sup>258</sup> the section is constitutional under both the U.S. and Texas constitutions;<sup>259</sup> *delivery* in U.C.C. section 2-725(2) does not mean delivery to the end user;<sup>260</sup> and the limitations period was not effectively waived by contract.<sup>261</sup>

One argument apparently overlooked by the plaintiff and not addressed by the court in *Armco* was that the implied right of indemnity is outside the Code and not governed by U.C.C. section 2-725.<sup>262</sup> However, this argument did surface and proved successful in *City of Wood River v. Geer-Melkus Construction Co.*<sup>263</sup> Pursuant to its contract with the City of Wood River, Geer-Melkus constructed a waste water treatment facility in which it installed a rotating media aeration system purchased from Hormel. More than four years later, when the system broke down, Wood sued Geer-Melkus, and Geer-Melkus filed

257. The facts indicated that it was allegedly impossible for American Alloy to have discovered the defects on its own. It was not until after burning and milling by Swecomex that they became discoverable. *Id.* at 174, 10 U.C.C. Rep. Serv. 2d at 863.

258. The court of appeals observed that the implied warranty of merchantability could not *explicitly* extend to the future performance of the good and the express warranty did not because it lacked a "specific reference to a specific date in the future." 777 S.W.2d at 176, 10 U.C.C. Rep. Serv. 2d at 864 (quoting *Safeway Stores, Inc. v. Certainteed Corp.*, 710 S.W.2d 544, 548, 1 U.C.C. Rep. Serv. 2d 1237, 1242 (Tex. 1986)).

259. The court disposed of the constitutional claim with dispatch, holding that "[a]doption of a uniform date of accrual and rejection of the discovery rule in warranty cases is a permissible means adopted by the state legislatures to protect commercial transactions." 777 S.W.2d at 177, 10 U.C.C. Rep. Serv. 2d at 865 (quoting *Muss v. Mercedes-Benz of North America*, 734 S.W.2d 155, 158-59, 4 U.C.C. Rep. Serv. 2d 1459, 1763 (Tex. Ct. App. 1987)).

260. The court indicated that because the purpose of U.C.C. section 2-725 was sufficiently different from U.C.C. sections 2-314, 2-607, and 2-714, there was no need to harmonize the four sections by adopting a uniform construction of "delivery." 777 S.W.2d at 177, 10 U.C.C. Rep. Serv. 2d at 865.

261. The waiver argument was based on the following contractual provision: "WAIVER. Failure or inability of either party to enforce any right hereunder shall not waive any right in respect to any other or future rights or occurrences." *Id.* at 177, 10 U.C.C. Rep. Serv. 2d at 865. The court held that this provision was not sufficiently specific to avoid the public policy ban on the enforceability of general agreements which waive in advance the statute of limitations. *Id.* at 177, 10 U.C.C. Rep. Serv. 2d at 866.

262. Opinion is divided on the proper statute of limitations when the action is for indemnity. Compare *PPG Indus. v. Genson*, 135 Ga. App. 248, 217 S.E.2d 479, 17 U.C.C. Rep. Serv. 785 (1975) (indemnity action subject to U.C.C. section 2-725); *Perry v. Pioneer Wholesale Supply Co.*, 681 P.2d 214, 38 U.C.C. Rep. Serv. 1274 (Utah 1984) (same); *with McDermott v. City of N.Y.*, 50 N.Y.2d 211, 406 N.E.2d 460, 428 N.Y.S.2d 643 (1980) (U.C.C. section 2-725 not applicable); *Cyr v. Michaud*, 454 A.2d 1376 (Me. 1983) (same); *Hanscome v. Perry*, 75 Md. App. 605, 542 A.2d 421, 7 U.C.C. Rep. Serv. 2d 1516 (1988) (same).

263. 233 Neb. 179, 444 N.W.2d 305, 9 U.C.C. Rep. Serv. 2d 957 (1989).

a third-party complaint against Hormel. The Supreme Court of Nebraska found that the third-party complaint raised an indemnification cause of action which first accrued when Geer-Melkus suffered loss or damage. Thus, U.C.C. section 2-725 was inapplicable.

What would have happened if all warranties had been disclaimed in the initial sale to Geer-Melkus? Presumably, it would not have had a claim over against Hormel.<sup>264</sup> This would suggest that regardless of its characterization, the "indemnification" cause of action is in reality grounded in a breach of warranty and, as such, should be treated accordingly. The fact that Geer-Melkus had no way of discovering the breach until the limitation period of U.C.C. section 2-725 had run is good reason to revise the statute, not to subvert its present scope.

Another way to resist the sometimes unjust consequences of the statute's date-of-delivery rule is to argue that the defendant's conduct precludes its use. The courts usually have denied such claims<sup>265</sup> but, as *Hydra-Mac, Inc. v. Onan Corp.*<sup>266</sup> proves, they occasionally prevail. In this case, International Harvester Company ("International Harvester") purchased skid loaders from Hydra-Mac with engines manufactured by Onan. From the outset, International Harvester knew that the engines were not performing well. Finally, after repeated attempts to remedy the problems, Onan gave up and admitted that the engines could never be repaired. By the time Hydra-Mac and International Harvester finally got around to suing Onan, it had been more than four years since the engines were delivered to Hydra-Mac. After dealing with the issue of whether the doctrine of fraudulent concealment was applicable and determining that it was not,<sup>267</sup> the Supreme Court of Minnesota turned to the issue of equitable estoppel.<sup>268</sup> It concluded that the case would have to be remanded in order to allow the trial court to determine whether International Harvester exercised due diligence in bringing suit once it became apparent that Onan's repair promises could not be kept. Having reached this conclusion, the court refused to decide whether the promises tolled the statute of limitations.<sup>269</sup>

264. The assumption is that the right of indemnification is recognized because of breach of contract, not tortious conduct on the part of Hormel.

265. For example, during this survey period courts declined to apply the doctrine of equitable estoppel in the following cases: *Deters v. Columbia Heights Motors*, 11 U.C.C. Rep. Serv. 2d 101 (Minn. Ct. App. 1989); *Connaught Laboratories, Inc. v. Lewis*, 557 A.2d 40, 10 U.C.C. Rep. Serv. 2d 134 (Pa. Commonw. Ct. 1989).

266. 10 U.C.C. Rep. Serv. 2d 740 (Minn. 1990).

267. The law of tolling of statutes of limitations, including the doctrine of fraudulent concealment, is explicitly saved by U.C.C. section 2-725(4) ("[t]his section does not alter the law on tolling of the statute of limitations. . . ."). While Onan might have concealed its inability to ever fix the engines, the problems were known to all concerned. This, the court thought, was enough to negate the claim of concealment.

268. The court noted the following elements to the estoppel: "(1) that promises or inducements were made; (2) that it reasonably relied upon the promises; and, (3) that it will be harmed if estoppel is not applied." 10 U.C.C. Rep. Serv. 2d at 749.

269. Buyers frequently argue that the seller's unsuccessful repair attempts toll the statute of limitations. Courts, however, have been generally unreceptive to this so-called "repair theory." See

Another possible way to extend the statute is to argue that some other statute, not U.C.C. section 2-725, is controlling. However, in a suit by a seller to recover the purchase price, the Supreme Court of Alabama held that U.C.C. section 2-725 governed, not the six-year period for simple contracts.<sup>270</sup> In another context, it was held that the strict products liability statute governed in a suit by a school district to recover the costs of asbestos removal.<sup>271</sup>

## ARTICLE SIX (BULK SALES)

Article 6 provides that a noncomplying bulk transfer is "ineffective" against the creditors of the transferor.<sup>272</sup> What seems clear is that one remedy afforded aggrieved creditors is the ability to reach the transferred goods. Unclear, however, is whether that is their only remedy. In *Streamlight, Inc. v. International Health & Safety Corp. (In re Streamlight, Inc.)*,<sup>273</sup> the creditor, a seller of health care products, sought a judgment against the noncomplying transferee/defendant equal to the value of its products actually received by the defendant.<sup>274</sup> Applying New York law, the bankruptcy court ruled that the defendant would be personally liable for the fair value of the merchandise transferred only to the extent that the merchandise was no longer in its possession and identifiable.<sup>275</sup> Accordingly, the defendant was ordered to account to the creditor for the present status or disposition of the merchandise.

Revised article 6 clarifies the consequences of the buyer's failure to comply.<sup>276</sup> It specifically provides that noncompliance will not render the sale ineffective or otherwise affect the buyer's title to the goods; rather, the liability of a noncomplying buyer will be for damages caused by the noncompliance.<sup>277</sup>

In *Key Capital Corp. v. M & S Liquidating Corp.*,<sup>278</sup> the Supreme Court of Massachusetts had occasion to define the words "major part" as used in U.C.C.

Kanovitz, *The Seller Fiddles and the Clock Ticks: Seller's Cure and the U.C.C. Statute of Limitations*, 60 Notre Dame L. Rev. 318 (1985).

270. See *Rivers Mach. Co., Inc. v. Barclay Int'l*, 553 So. 2d 579, 11 U.C.C. Rep. Serv. 2d 890 (Ala. 1989).

271. See *Drayton Public School District No. 19 v. W.R. Grace & Co.*, 728 F. Supp. 1410 (D.N.D. 1989).

272. U.C.C. §§ 6-104(1), 6-105.

273. 108 Bankr. 505, 10 U.C.C. Rep. Serv. 2d 1372 (E.D. Pa. 1989).

274. This was probably a mistake. Nothing in article 6 would suggest a reduction in the amount of the creditor's claim from that which is owed by the debtor/transferor. Fortunately for the creditor, the bankruptcy court recognized the mistake. It noted that "the relief provided . . . may make it possible for the [debtor], to collect its entire judgment against the [creditor]. . . ." *Id.* at 511, 10 U.C.C. Rep. Serv. 2d at 1377.

275. The court relied on New York caselaw, see *In re Curtina Int'l*, 23 Bankr. 969, 34 U.C.C. Rep. Serv. 1311 (S.D.N.Y. 1982), and the fact that New York has enacted a very limited version of U.C.C. section 6-106. See N.Y.U.C.C. § 6-112 (transferee liable only for certain taxes owed by the transferor).

276. Revised article 6 (cited herein as "revised U.C.C.") has been adopted by California, Oklahoma, and Utah.

277. See Revised U.C.C. § 6-107.

278. 27 Mass. App. Ct. 721, 9 U.C.C. Rep. Serv. 2d 710 (1989).

section 6-102(1).<sup>279</sup> The transferor/debtor had transferred somewhere between 23% and 26% of its inventory of meat and meat products. The court held that this transaction did not constitute a bulk sale because it did not meet the quantitative test of article 6. In so doing it adopted the bright line test favored by the overwhelming majority of courts and commentators: "the words 'major part' . . . mean, as a matter of law, more than [50%] of the property transferred, measured by value."<sup>280</sup> The definition of "bulk sale" in revised article 6 expressly adopts this interpretation.<sup>281</sup>

Not every transaction which meets the general definition of a bulk transfer necessitates compliance with article 6. The case of *Baltimore Luggage Co. v. Holtzman*<sup>282</sup> demonstrates that even if the transfer is not expressly excepted from the Act's coverage under U.C.C. section 6-103, a court may nonetheless be willing to excuse noncompliance. In *Holtzman*, the transaction was in all respects an arm's length transaction under which the transferee assumed substantially all of the seller's liabilities and obligations, and the seller acknowledged and retained the rest: specifically, the obligations arising under its employment contract with the plaintiff.<sup>283</sup> Concluding that none of the purposes of article 6 would be frustrated if a non-fraudulent transaction of this type was outside its scope,<sup>284</sup> the court held that compliance was unnecessary. What the court misses is the entire point of a bulk sales act. By providing for notice before the sale it affords creditors the opportunity to police the transaction and makes available to them remedies which would be lost or worthless after the sale.<sup>285</sup> Moreover, some of these remedies (garnishment, for example) are available regardless of whether the sale is fraudulent or not.

279. U.C.C. section 6-102(1) provides: "A 'bulk transfer' is any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory . . . of an enterprise subject to this Article."

280. 27 Mass. App. Ct. at 725, 9 U.C.C. Rep. Serv. 2d at 714. If a "substantial part" of equipment is transferred in conjunction with a bulk transfer of inventory, that transfer too is subject to article 6. See U.C.C. § 6-102(2). The court, quoting 6 Hawkland, Uniform Commercial Code Series 6-102:09 (1984), makes the point that unlike the words "major part" no consensus exists on the meaning of "substantial part" other than it means something quantitatively less than "major." *Id.* at 725, 9 U.C.C. Rep. Serv. 2d at 714 n.6.

281. See revised U.C.C. § 6-102(1)(c).

282. 562 A.2d 1286, 10 U.C.C. Rep. Serv. 2d 953 (Md. Ct. Spec. App. 1989).

283. The court raises but does not answer the question of whether an employee under a contract is a creditor for purposes of article 6.

284. The two purposes identified by the court were: (1) protection of the transferor's creditors from a fraudulent transfer of assets, and (2) protection of complying purchasers against attachment of or levy on the transferred goods. 562 A.2d at 1294, 10 U.C.C. Rep. Serv. 2d at 958.

285. See U.C.C. § 6-105 Comment 1 ("This section is the heart of the Article. It requires notice to creditors of all bulk transfers subject to the Article. . . ."). After the sale has taken place the proceeds may have vanished and the assets transferred may have been resold or encumbered. Furthermore, pre-sale remedies such as injunction will no longer be feasible.

**ARTICLE SEVEN (DOCUMENTS OF TITLE)**

Two cases concern the effectiveness of a limitation of liability provision in a document of title where the bailed goods have disappeared from the bailee's premises under unknown circumstances. The relevant article 7 sections validate limitation of liability provisions in warehouse receipts and bills of lading unless the bailee has converted the bailed goods to its own use.<sup>286</sup>

In *Ferrex Int'l. Inc. v. M/V Rico Chone*<sup>287</sup> the U.S. District Court for the District of Maryland, applying Maryland law, enforced such a provision on the ground that the owner of the bailed goods had failed to prove a prima facie case of conversion. In that case the owner (Ferrex) delivered several packages of welding rods to the dock operator (Clark Maryland Terminals) for storage until the arrival of the ship on which the rods were to be transported. When the ship arrived the rods were found to be missing. It was never proved how the rods actually disappeared. The owner of the rods sued the dock operator who defended on the basis of a provision in the dock receipt limiting its liability to \$500 per package unless a higher valuation had been declared (which the owner had not).<sup>288</sup> The owner argued that the dock operator's failure to return goods bailed to it raised a presumption of conversion, and that to rebut that presumption the dock owner must produce more than just speculative evidence about what happened to the bailed goods. The district court disagreed. It held that the unexplained disappearance of bailed goods gave rise to a presumption of negligence not conversion. The burden remained upon the owner to prove that the goods had disappeared under circumstances amounting to conversion by the bailee. This burden the owner failed to carry. The presumption of negligence was useless, since the limitation of liability provision was effective even if the dock operator negligently caused the loss.<sup>289</sup> Therefore, the court granted summary judgment for the dock operator.

In *Calvin Klein Ltd. v. Trylon Trucking Corp.*<sup>290</sup> the Second Circuit, applying New York law, held that a limitation of liability provision in a trucking invoice was effective even where the carrier had been grossly negligent. In that case the owner of the goods and the shipper had done business on numerous occasions over the last three years before suit. In each instance, the trucker would pick up a shipment from the airport and transport it to the owner's facilities. After completing the job, the carrier would forward to the owner an invoice containing a limitation of liability provision. The shipment giving rise to this suit was stolen by the driver of the truck and never recovered. Since the carriage was never completed the carrier issued no invoice for this shipment. The owner sued the carrier, who defended on the basis of the limitation of liability provision in its previous invoices. The parties stipulated

286. U.C.C. § 7-204(2) (warehouse receipt); U.C.C. § 7-309(2) (Bill of Lading).

287. 718 F. Supp. 451, 10 U.C.C. Rep. Serv. 2d 960 (D. Md. 1988).

288. See *ICC Metals, Inc. v. Municipal Warehouse Co.*, 50 N.Y.2d 657, 431 N.Y.S.2d 372, 409 N.E.2d 849, 29 U.C.C. Rep. Serv. 217 (1980).

289. Cf. U.C.C. § 7-204 Comment.

290. 892 F.2d 191, 10 U.C.C. Rep. Serv. 2d 970 (2d Cir. 1989).

that the carrier had been grossly negligent in hiring the truck driver, and that the contract of carriage for the stolen shipment included the limitation of liability provision. The district court held for the owner. It ruled that the limitation of liability provision had not been assented to by the owner. Since no invoice had been issued for the stolen shipment, the court declined to infer assent from the parties' previous course dealings. The district court also ruled that gross negligence would not override the limitation of liability provision. The Second Circuit reversed and remanded. It held the question of whether the owner had assented to the limitation of liability provision to be foreclosed by the parties' stipulation that this provision was part of the contract. It agreed with the district court that gross negligence would not override that provision.

In *Michigan National Bank v. Michigan Livestock Exchange*<sup>291</sup> the Michigan Supreme Court found liable in conversion an auctioneer who acted in good faith in selling livestock covered by a security interest. In that case the secured creditor had loaned money to the debtors and had taken a security interest (which it perfected) in the debtors' cattle. The auctioneer sold the cattle without knowledge of the security interest and remitted the proceeds to the debtors. In a conversion suit against the auctioneer by the secured creditor, the trial court granted summary judgment for the secured creditor. The court of appeals reversed and remanded for the trial court to consider the applicability of U.C.C. section 7-404. That section protects from liability a good faith bailee who acts reasonably and delivers goods in accordance with the terms of the document of title.<sup>292</sup> The trial court reinstated its summary judgment for the secured creditor, holding U.C.C. section 7-404 not to be applicable. The court of appeals reversed and entered summary judgment for the auctioneer holding that section 7-404 shielded the auctioneer from liability. The Michigan Supreme Court reversed the court of appeals. It concluded that section 7-404 did not apply to the auctioneer for several reasons: first, the auctioneer was not an article 7 bailee, that is, a bailee for storage or transportation; second, the trucker's receipt issued by the auctioneer was not a document of title.<sup>293</sup> The court's conclusion that section 7-404 does not cover an auctioneer is consistent with the caselaw.<sup>294</sup>

291. 439 N.W.2d 884, 9 U.C.C. Rep. Serv. 2d 366 (Mich. 1989).

292. U.C.C. § 7-404 provides:

**NO LIABILITY FOR GOOD FAITH DELIVERY PURSUANT TO RECEIPT OF BILL.**

A bailee who in good faith including observance of reasonable commercial standards has received goods and delivered or otherwise disposed of them according to the terms of the document of title or pursuant to this Article is not liable therefor. This rule applies even though the person from whom he received the goods had no authority to procure the document or to dispose of the goods and even though the person to whom he delivered the goods had no authority to receive them.

293. The court also held that U.C.C. section 9-307(1) did not shield the auctioneer from liability. See 439 N.W.2d at 892-95, 9 U.C.C. Rep. Serv. 2d at 377-81.

294. See the authorities cited by the court, 439 N.W.2d at 892, 9 U.C.C. Rep. Serv. 2d at 376-77. See also *Johnson v. New Holland Sales Stable, Inc.*, 71 Lanc. L. Rev. 925, 11 U.C.C. Rep. Serv. 2d 323 (Pa. C.P. 1989).

Several jurisdictions have sought to remedy the auctioneer's difficult situation by statute, usually amending U.C.C. section 9-307(1).<sup>295</sup>

295. *See, e.g.*, Mich. Comp. Laws § 440.9307 discussed 439 N.W.2d at 895-98, 9 U.C.C. Rep. Serv. 2d at 381-86. *Cf.* Food Security Act, 7 U.S.C.A. § 1631 (West 1988).