

D R A F T
FOR DISCUSSION ONLY

**UNIFORM COMMERCIAL CODE
ARTICLE 2 – SALES (199__)**

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**UNIFORM COMMERCIAL CODE
ARTICLE 2 – SALES (199__)**

WITH COMMENTS

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UNIFORM COMMERCIAL CODE
ARTICLE 2 – SALES (199__)

PART 1
GENERAL PROVISIONS

SECTION 2-101. SHORT TITLE. This [article] may be cited as Uniform Commercial Code – Sales.

SECTION 2-102. DEFINITIONS.

(a) In this [article]:

(1) “Agreement to sell” includes both a present sale and a contract to sell at a future date, whether or not the goods exist at the time of the agreement.

[Section 2-2101(1) (May, 1995)]

(2) “Banker’s credit” means an irrevocable credit issued by a financing agency of good repute and, if the shipment is overseas, of good international repute.

(3) A transaction “between merchants” means a transaction between parties both of whom are chargeable with the knowledge or skill of merchants.

(4) “Buyer” means a person who buys or contracts to buy goods.

(5) “Cancellation” means an act by either party which ends a contract because of a breach by the other party.

(6) “Check” means a draft, other than a documentary draft, payable on demand and drawn on a bank, or a cashier’s check or teller’s check. An instrument may be a check even if it described on its face by another term, such as a money order. **[Section 3-104(e)]**

(7) “Commercial unit” means a unit of goods which by commercial usage is a single whole for purposes of sale and whose division materially impairs

its character or value in the relevant market or in use. A commercial unit may be a single article, such as a machine; a set of articles, such as a suite of furniture or an assortment of sizes; a quantity, such as a bale, gross, or carload; or any other unit treated in use or in the relevant market as a single whole.

(8) “Conforming or “conforming to the contract, as used with respect to goods or conduct that includes any part of a performance, means in accordance with the obligations under the contract.

(9) “Conspicuous, with reference to a term or clause, means so displayed or presented that a reasonable person against whom it is to operate would likely have noticed it or, in the case of an electronic message intended to evoke a response without the need for review by an individual, in a form that would enable the recipient or the recipient's computer to take it into account or react to it without review of the message by an individual. A term or clause is conspicuous if it is:

(i) in a record and is a printed heading in capitals;

(ii) language in the body of a standard form record that is in larger or other contrasting type or color than other language in the form; or

(iii) a term or clause referred to in the body of a record by conspicuous language if the term or clause can be readily accessed from the record in which it is referred. **[Section 2B-102(a)(8), Section 2-2101(4) (May, 1995)]**

(10) “Consumer means an individual who buys or contracts to buy consumer goods.

(11) “Consumer contract means a contract for the sale of consumer goods between a seller regularly engaged in the business of selling and a consumer buyer. **[compare Section 2A-103(1)(a)]**

(12) “Consumer goods means goods that when delivered are intended by the buyer primarily for personal, family, or household use.

(13) “Contract” includes a contract for sale.

(14) “Contract for sale” includes both a present sale of goods and a contract for the sale of future goods, whether or not the goods exist at the time of contracting.

(15) “Contract price” means the consideration paid or to be paid for a transfer.

(16) “Cover” means to make in good faith and without unreasonable delay a reasonable purchase of or contract to purchase goods in substitution for those due from the transferor.

(17) “Delivery” means the transfer of physical possession or control of goods. **[Section 2-2101(9) (May 1995)]**

(18) “Draft” means a negotiable instrument that is an order. **[Section 3-104(b)]**

(19) “Electronic agent” means a computer program designed, selected, or programmed by a party to initiate or respond to electronic messages or performances without review by an individual. An electronic agent acts within the scope of its agency if its performance is consistent with the functions intended by the party who utilizes the electronic agent. **[Section 2B-102(a)(15)]**

(20) “Electronic message” means a record generated or communicated by electronic, optical, or other analogous means for transmission from one information system to another. The term includes electronic data interchange and electronic mail. **[Section 2B-102(a)(16)]**

(21) “Electronic transaction” means a transaction in which the parties, or their intermediaries, contemplate that an agreement may be formed through the use of electronic messages or responses, whether or not either party anticipates that

the information or records exchanged will be reviewed by an individual. **[Section 2B-102(a)(17)]**

(22) “Financing agency” means a bank, finance company, or other person that, in the ordinary course of business, makes advances against goods or documents of title, or that by arrangement with either the seller or the buyer intervenes in the ordinary course of business to make or collect payment due or claimed under a contract for sale, as by purchasing or paying the seller's draft, making advances against it, or merely taking it for collection, whether or not documents of title accompany the draft. The term includes a bank or other person that similarly intervenes between persons in the position of seller and buyer with respect to the goods.

(23) “Future goods” means goods that are not both existing and identified.

(24) “Good faith” means

ALTERNATIVE A

honesty in fact in the conduct or transaction concerned. **[Section 1-201(19)]**

ALTERNATIVE B

, in the case of a merchant, honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade. **[Section 2-103(1)(b)]**

ALTERNATIVE C

honesty in fact and the observance of reasonable commercial standards of fair dealing in the conduct or transaction concerned. **[Section 3-103(a)(4)]**

(25) “Goods” means all things, including specially manufactured goods, that are movable at the time of identification to the contract for sale and, unless the context otherwise requires, future goods. The term also includes the unborn young of animals, growing crops, and other identified things attached to realty as described in Section 2-108. However, the term does not include money in which

the price is to be paid, obligations arising from foreign exchange transactions, investment securities, documents, instruments, accounts, chattel paper, general intangibles, and intangibles contracts.

(26) Intermediary with respect to an electronic message means a person or entity that, on behalf of another, receives, transmits, stores, or provides other services with respect to a record or information. The term does not include a common carrier employed or used in that capacity. **[Section 2B-102(a)(25)]**

(27) “Lot” means a parcel or single article that is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(28) A party “manifests assent” to a record if, after having an opportunity to review the terms of the record, the party engages in conduct that under the circumstances constitutes acceptance of the terms of the record and the party had an opportunity to decline to engage in the conduct. **[See Section 2B-115, a separate section on “manifesting assent.”]**

(29) “Merchant” means a person who deals in goods of the kind or who otherwise by the person's occupation purports to have knowledge or skill particular to the practices or goods involved in the transaction, or a person to whom knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary who purports to have the knowledge or skill.

(30) A party has an “opportunity to review” a record if the record is made available in a manner designed to call the terms to the attention the party before assent to the record or is provided in such a manner that the terms will be conspicuous in the normal course of initial use or preparation to use the goods. **[See Section 2B-116, a separate section on “opportunity to review”]**

(31) “Present sale” means a sale that is effected by the making of the contract.

(32) “Receipt” means the taking of physical possession of goods.

(33) “Record,” when used as a noun, means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. **[Section 2B-102(a)(35)]**

(34) “Sale” means the passing of title to goods from a seller to a buyer for a price.

(35) “Seller” means a person who sells or contracts to sell goods.

(36) “Sign,” when used as a verb, means to identify a record by means of any symbol executed or adopted by a party with present intention to authenticate the record. “Signed” has an analogous meaning. An electronic record is a signed record if a method of authentication identifying the originator of the record and indicating the originator's approval of the information contained therein is used and that method has been agreed on between the parties or was as reliable as appropriate for the purpose for which the record was generated or communicated in light of all the circumstances. **[UNCITRAL EDI Draft]**

(37) “Standard form” means a record prepared by one party in advance for general and repeated use that substantially contains standard terms and was used in the transaction without negotiation of, or changes in, the substantial majority of the standard terms. Negotiation of price, quantity, time of delivery or method of payment does not preclude a record from being a standard form. **[Section 2B-102(a)(40)]**

(38) “Standard terms” means terms prepared in advance for general and repeated use by one party and used without negotiation with the other party. **[Section 2B-102(a)(41), UNIDROIT Principles, Article 2.19(2)]**

(39) “Substantial performance means performance of a contractual obligation in a manner that does not constitute a material breach of contract.

[Section 2B-102(a)(42)]

(40) “Termination means an act by a party to a contract under a power created by agreement or law which ends the contract for a reason other than for breach. **[Section 2B-102(a)(43)]**

(b) In addition, [Article] 1 contains general definitions and principles of construction applicable throughout this [article].

SOURCE: Sales (October, 1995); Licenses (February, 1996)

Notes

1. These definitions come primarily from the October, 1995 Draft of Article 2, which, in turn, drew upon the May, 1994 and the May, 1995 Drafts. Sources not noted come from the 1990 Official Text of Article 2. Other definitional sources include Revised Article 2B, Licenses (Feb. 1996) and the UNCITRAL Draft Model Law on EDI. Definitions that relate primarily to licenses have been excluded from this draft.

SECTION 2-103. SCOPE.

(a) Unless the context otherwise requires, this [article] applies to any:

(1) transaction, regardless of form, that creates a contract for the sale of goods, including a contract in which a sale of goods predominates;

(2) claim that goods supplied under a contract in which the sale of goods does not predominate fail to conform to the terms of the contract; and

(3) term in a contract for sale or a collateral contract obligating the seller to install, customize, service, repair, or replace the goods sold at or after the time of delivery.

(b) If a transaction involves information and goods that are not copies of the information or documentation pertaining to the information, this [article] applies to the aspects of the transaction that involve the goods and their

performance and rights in the goods, but [Article] 2B applies to the aspects of the transaction involving the information and copies or documentation of the information.

(c) Except as provided in subsection (b), if another [article] of the Uniform Commercial Code applies to a transaction governed by this [article], this [article] does not apply to the part of the transaction governed by that other [article].

Notes

1. Article 2 covers but is not limited to transactions that create a contract for the sale of goods. Although a “pure” service contract is not covered, a mixed transaction is covered if the sale of goods rather than the furnishing of services “predominates.” Thus, subsection (a)(1) codifies the test used by most courts without attempting to state when one or the other predominates. If goods predominate Article 2 applies to the entire transaction.

2. Suppose a party furnishes goods as part of a transaction where services predominate. The goods do not conform to the terms of the contract and the other party suffers loss. Subsection (a)(2) states that Article 2 applies to the question whether the goods conformed to the contract and any remedies asserted for breach. This follows the case law, particularly where the goods have retained their independent status. Non-code law applies to other issues arising under the contract.

3. Subsection (a)(3) states explicitly that courts may apply Article 2 to a common type of service contract, the contract where the seller, not a third person, agrees to install, service and repair goods sold at or after the time for delivery. The agreement may be part of or collateral to the contract for sale. Standards for measuring the seller's obligation in these contracts are provided in Sections 2-501 through 2-504. In a typical case, the buyer may have a claim for breach of warranty and for breach of an agreement to repair or replace the non-conforming goods. Article 2 applies to both claims.

4. Although not stated in Section 2-103, courts are invited to extend Article 2 by analogy to transactions not within its scope if the extension is relevant in principle and appropriate in the circumstances. See *Barco Auto Leasing Corp. v. PSI Cosmetics, Inc.*, 478 N.Y.S.2d 505 (New York Civ. Ct. 1984) (explores theory of extension by analogy).

5. Subsection (b) deals with transactions where goods and information licensed under Article 2B are involved. See Section 2B-102(a)(21). To each his own on this one.

6. Subsection (c), which is subject to subsection (b), defines the relationship between Article 2 and other articles in the UCC. It follows Section 2B-103(b). More work should be done here.

SOURCE: Section 2B-103 (Feb. 1996); Sales (October, 1995)

SECTION 2-104. TRANSACTIONS SUBJECT TO OTHER LAW.

(a) A transaction subject to this [article] is also subject to any applicable:

(1) federal law to the extent that it governs the rights of parties to, and third parties affected by, the transaction;

(2) consumer protection law of this State; and

(3) [mesh with other law of this State].

(b) In the case of a conflict between this [article] and a law referred to in subsection (a), that law governs.

SOURCE: See Section 2B-104 (February, 1996)

Notes

1. The line between the United Nations Convention on Contracts for the International Sale of Goods, which is federal law, and Article 2, which is state law, will be clear in most cases. Under Article 1, CISG applies to “contracts of sale of goods between parties whose places of business are in different states: (a) when the States are Contracting States. Canada and the United States are contracting States. Thus, if a Canadian seller sued a United States buyer in the Southern District of New York, CISG rather than Article 2 would apply even though federal jurisdiction was based upon diversity of citizenship. See *Filanto, S.p.A. v. Chilewich Intern. Corp.*, 789 F. Supp. 1229 (S.D.N.Y. 1992), appeal denied, 984 F.2d 58 (2d Cir. 1993). Article 2, in short, is preempted by federal law.

There are exceptions based upon CISG's more limited scope. CISG would not apply if the buyer were a consumer, Article 2(a), or the subject of the sales was an “aircraft or “electricity. Article 2(d) and (e). Article 2, however, applies to these transactions. In addition, CISG does not apply to certain aspects of a sale otherwise covered. Thus, CISG is “not concerned with: (a) the validity of the contract or of any of its provisions or of any usage; (b) the effect which the contract may have on the property in the goods sold, Article 4, and “does not apply to the liability of the seller for death or personal injury caused by the goods to any person. Article 5. Article 2 applies to “validity disputes involving unconscionability, Section 2-105, claims for personal injury resulting from a breach of warranty, Section 2-706(a)(2), and disputes over title. Finally, CISG applies only to disputes between the parties to a contract for sale. Lack of contractual privity is a defense in a suit under CISG. Under Article 2, however, a remote buyer may be able to sue a seller for breach of warranty. Lack of contractual privity, in these cases, is not a defense. See Section 2-318. Since Article 2 does not define “seller to exclude a seller under CISG, a remote United States buyer of imported goods presumably can sue a Canadian seller for breach of warranty under Article 2.

SECTION 2-105. UNCONSCIONABLE CONTRACT OR CLAUSE.

(a) If a court finds as a matter of law that a contract or any clause thereof was unconscionable at the time it was made or was induced by unconscionable conduct, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable clause, or so limit the application of any unconscionable clause as to avoid an unconscionable result.

(b) Before making a finding of unconscionability under subsection (a), the court, on motion of a party or its own motion, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the contract or clause thereof or of the conduct.

SOURCE: Sales, Section 2-302 (December, 1994)

Notes

1. Except for the language “induced by unconscionable conduct,” Section 2-105 is the same as Section 2-302 in the 1990 Official Text. Section 2-105 does not adopt the broader language of Section 2A-108. A proposal to conform original Section 2-302 to Section 2A-108(2) and (3) was rejected by the Drafting Committee at the October, 1993 meeting. The phrase “induced by unconscionable conduct,” taken from Section 2A-108(2), was added. The “induced” phrase, however, does not appear in 2B-111.

2. The expanded treatment of consumer contracts and standard form contracts in Article 2 is a particularized application of unconscionability concepts. See, e.g., Sections 2-206 and 2-316. Nevertheless, Section 2-105 may still apply to a dispute even though the requirements of those particular sections has been satisfied. Thus, a disclaimer of warranty that satisfies the requirements of Section 2-316(b) may still be unconscionable on other grounds.

3. The Drafting Committee limited unconscionability to the time of contracting and concluded that the remedy should be avoidance or limitation of the contract or clause rather than damages. A proposal that the court have power as a matter of law to find that a “contract or any clause thereof is unconscionable” was rejected.

SECTION 2-106. ALLOCATION OR DIVISION OF RISKS. Whenever this [article] allocates a risk or imposes a burden as between the parties, the agreement may shift the allocation and apportion the risk or burden.

SOURCE: Sales, Section 2-303 (December, 1994)

SECTION 2-107. INTERESTS AND PART INTERESTS IN GOODS.

(a) Goods must be both existing and identified before an interest in them may be transferred.

(b) A part interest in existing, identified goods may be sold.

(c) A purported present sale of future goods or an interest therein is a contract to sell future goods.

(d) An undivided share in a described bulk of fungible goods is sufficiently identified to be sold, even if the quantity of the bulk is not determined. Any proportion of the bulk or quantity agreed upon by number, weight, or other measure, to the extent of the seller's interest in the bulk, may be sold to the buyer. The buyer is an owner in common.

SOURCE: Sales, Section 2-105 (Oct. 1995)

SECTION 2-108. GOODS TO BE SEVERED FROM REALTY; RECORDING.

(a) A contract for the sale of minerals, oil, gas, or similar things or a structure or its materials, to be extracted or removed from real property, is a contract for the sale of goods if they are to be severed by the seller. Until severance, a purported present sale of those things, other than a sale that is effective as a transfer of an interest in the real property, is only a contract to sell future goods.

(b) A contract for the sale, apart from an interest in real property, of growing crops, timber to be cut, or other things attached to real property and capable of severance without material harm to the real property other than the things described in subsection (a) is a contract for sale of goods, whether the thing is to be severed by the buyer or seller and even if it forms part of the real property at

the time of contracting. The parties may effect a present sale before severance by identification of the goods.

(c) The rights of a buyer and seller under this section are subject to rights of third parties under the laws relating to records of real property. A contract for sale may be executed and recorded as a document transferring an interest in real property. The recording constitutes notice to third parties of the buyer's rights under the contract for sale.

SOURCE: Sales, Section 2-107 (December, 1994)

Notes

1. Section 2-108 implements a suggestion by the California State Bar Committee that there should be consistency in terminology. Thus, the phrase “real property” is substituted for the terms “realty” and “land” on the assumption that all mean the same thing.

2. The CSBC also questioned use of the undefined phrase “contract to sell” in Sections 2-107(b) and 2-108(a) [found in the original Article 2] rather than the defined phrase “contract for sale,” which includes a contract for the sale of future goods. The phrase “contract for the sale of future goods” is proposed to replace “contract to sell.”

SECTION 2-109. EFFECT OF AGREEMENT.

(a) Except as otherwise provided in subsection (b) or in the applicable section, the effect of any provision of this [article] may be varied by agreement of the parties. The absence of a phrase such as “unless otherwise agreed” does not indicate that the provisions cannot be varied by agreement.

(b) An agreement subject to this [article] may not limit or vary:

- (1) the obligation of good faith under Sections 1-203 and 2-102(a)(24);
- (2) the effect on use of parol or extrinsic evidence under Section 2-202(b);
- (3) the right to relief from an unconscionable contract or clause under Section 2-105;

(4) the effect of Section 2-316 concerning the negation or limitation of express warranties;

(5) the effect of Section 2-318 concerning the extension of warranties;

(6) _____

Notes

1. This section states which sections of Article 2 can and cannot be varied by agreement of the parties. It supplements Section 1-102(3). Subsection (a) states a broad principle favoring variation unless otherwise provided in the particular section (the phrase “unless otherwise agreed” is no longer needed) and subsection (b) states an incomplete list of principles that cannot be varied.

Other sections that cannot be limited or varied by agreement include the scope of the parties' power to liquidate damages, Section 2-710(a), the right to assign contract rights, Section 2-403, reduction of the statute of limitations to less than one year, Section 2-714, and the rights of persons not parties to the contract.

PART 2
FORMATION, TERMS, AND READJUSTMENT OF CONTRACT

SECTION 2-201. NO FORMAL REQUIREMENTS.

(a) A contract or modification thereof is enforceable, whether or not there is a record signed by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year after its making.

(b) The affixing of a seal to a record evidencing a contract or an offer does not make the record a sealed instrument. The law with respect to sealed instruments does not apply to the contract or offer.

SOURCE: Sections 2-201 and 2-203 (October, 1995)

Notes

1. Revised Section 2-201(a) was approved by the Drafting Committee on March 6, 1993. A motion to restore the statute of frauds was rejected by a voice vote of the Commissioners at the 1995 Annual Meeting of NCCUSL. The revision repeals the statute of fraud requirements in Sections 2-201 and 2-209 of the 1990 Official Text and the “one year” provision in the general statute of frauds, to the extent that the formation or modification of a contract for sale are involved. Commercial parties, however, may still agree that a contract modification must be in a signed record. See Section 2-210(2).

2. Repeal of the statute of frauds for sales contracts is consistent with the law in England and Article 12 of CISG. There is, however, a statute of frauds for leases of goods, Section 2A-201. See also Section 2B-201 (Feb. 1996), where options are provided.

3. The original statute of frauds was intended to reduce the risk that perjured evidence of the existence or the terms of the alleged contract for sale would confuse the 17th Century finder of fact. The Drafting Committee concluded that this risk is neutralized by the modern fact finding process and that a sampling of recent cases suggest that current Section 2-201 is frequently used to avoid liability in cases where there was credible evidence of an agreement and no evidence of perjury. Moreover, there is no persuasive evidence that the valuable habit of reducing agreements to a signed record will be adversely affected by the repeal. After all, Section 2-201(1) can be satisfied by a signed napkin that simply states “deal with Bob, 10 tons. See James J. White & Robert S. Summers, Uniform Commercial Code § 2-8 (4th ed. 1995) (evaluating statute of frauds).

4. The law relating to sealed instruments, formerly stated in Section 2-203, now appears in Section 2-201(b).

SECTION 2-202. FINAL WRITTEN EXPRESSION; PAROL OR EXTRINSIC EVIDENCE.

(a) Terms on which confirmatory memoranda of the parties agree, or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to the included terms, may not be contradicted by evidence of a previous agreement or a contemporaneous oral agreement. However, the terms may be explained or supplemented by evidence of:

- (1) course of dealing, usage of trade, or course of performance; and
- (2) noncontradictory additional terms unless the court finds that the writing was intended as a complete and exclusive statement of the terms of the agreement.

(b) In determining whether the parties intended a writing or record to be final or complete and exclusive with respect to some or all of the terms, the court shall consider all evidence relevant to intention to integrate the document, including evidence of a previous agreement or representation or of a contemporaneous oral agreement or representation.

SOURCE: Sales, Section 2-202 (March, 1995)

Notes

1. If, after a preliminary hearing authorized by Section 2-202(b), the court concludes that the parties intended a partially integrated writing, Section 2-202(a) states when evidence of prior agreements or contemporaneous oral agreements is excluded. Evidence is excluded if it contradicts terms in the record but evidence is admitted if it proves a non-contradictory additional term. This latter ground for admissibility changes original Section 2-202, which excluded evidence of “inconsistent additional terms, and arguably narrows the effect of a partial integration. The change follows Comment 3 of the original Section 2-202, which stated that if the “additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact. **But see Section 2B-301(a)(2) (Feb. 1996), which retains the “consistent additional terms” language.**

2. The effect of a totally integrated record is that both contradictory and non-contradictory additional terms are excluded. The best evidence of a total

integration is a so-called “merger clause. The last sentence of Section 2-202(b) in the May, 1994 Draft stated that a merger clause does not create a conclusive presumption of a total integration. Although this sentence was consistent with the case law, see, e.g., *ARB, Inc. v. E-Systems, Inc.*, 663 F.2d 189, 198-199 (D.C. Cir. 1980), it was removed at the March, 1995 meeting of the Drafting Committee. As a practical matter, a merger clause creates a presumption that both parties intended a total integration and puts a difficult burden on one party to establish the contrary. **See Section 2B-301(b) (Alternative 2) (Feb. 1996), stating that a merger clause not in a standard form is “presumed to state the intent of the parties on this issues.”**

3. In the case of either a partial or a total integration, terms in the record may be “explained or supplemented ... by course of dealing or usage of trade or by course of performance. Section 2-202(a)(1). Evidence intended to explain a term in a record is relevant to contract interpretation. The parol evidence rule does not apply. Evidence intended to supplement a term in a record poses in different language the problem of whether additional terms are contradictory or not. But unless the record clearly excludes or contracts out of the trade usage or course of dealing or performance, both Sections 1-205(3) and 2-202(a)(1) support admissibility to supplement even though it may also appear to vary or contradict that term. The reason is the special status of this evidence (it is not directly related to pre-contract negotiations) and the assumption that the parties intended to include it unless otherwise clearly agreed. See, e.g., *Nanakuli Paving & Rock Co. v. Shell Oil Co., Inc.*, 664 F.2d 772 (9th Cir. 1981).

4. Subsection (c) of the May, 1994 Draft, which stated that before extrinsic evidence was admissible to interpret a contract the court must find that the contract was ambiguous, was deleted at the March, 1995 meeting of the Drafting Committee. Subsection (c), which sparked controversy, was inconsistent with the policy of the 1990 Official Text, Section 2-202, Comment 1(c), the Restatement, Second of Contracts, see §§ 200-203, and the approach of most courts. See, e.g., *Pacific Gas & Electric Co. v. G. W. Thomas Drayage & Rigging Co.*, 442 P.2d 641 (Cal. 1968) (Traynor, Chief Justice). Thus, the courts, as before, are left to decide whether a merger clause is conclusive on the question of intention and when extrinsic evidence should be admitted to interpret language in the record.

At the October, 1995 meeting of the Drafting Committee, the scope of the court's power to interpret a term in an integrated writing was discussed. Concern was expressed lest the phrase “terms may be explained” in Section 2-202(a) would be limited to the sources listed in (1) and (2) and that the dreaded “plain meaning rule” might reemerge. A motion to save the phrase passed, however, [9-8, 7-0] with the expectation that the Comments would state that the sources of evidence for contract interpretation are broader than those indicated in subsection (a). See CISG Article 8(3). [**New, January, 1996**]

5. In October, 1993, the Drafting Committee rejected motions that (1) a standard form merger clause in a consumer contract is inoperative against a consumer (2) a standard form merger clause in a consumer contract is not enforceable unless the party asserting it proves by clear and convincing evidence that the consumer “understood and expressly agreed to” the clause. A motion to approve the draft as presented was approved by the Commissioners present but rejected by a vote of all persons present. The conclusion of those adhering to the

present draft was that revised Section 2-202(b) gives the court sufficient flexibility to sort out cases where there is unfair surprise or no real assent, whether the issue involved using a merger clause as (1) a substitute for an inoperative disclaimer of express warranties, see Section 2-316(a), or (2) a device to exclude other terms agreed in the negotiating process. See Section 2-302.

Lingering dissatisfaction with this outcome will be moderated by new Section 2-206, dealing with standard form contracts and terms.

SECTION 2-203. FORMATION IN GENERAL.

(a) A contract may be made in any manner sufficient to manifest agreement, including by offer and acceptance and conduct of both parties recognizing the existence of the contract.

(b) If the parties so intend, an agreement sufficient to make a contract may be found even if the time when the agreement was made cannot be determined, one or more terms are left open or to be agreed upon, or standard terms in the records of the parties do not otherwise establish a contract.

(c) If a contract is made and one or more terms in the agreement are left open, the contract does not fail for indefiniteness if there is a reasonably certain basis for an appropriate remedy.

(d) Language in a standard form or a standard term which conditions the intention of that party to be bound upon further agreement by the other party must be clear and conspicuous.

SOURCE: Sales, Section 2-204 (December, 1994)

Notes

1. In transactions where standard terms in the records of one or both parties do not agree, the issue of contract formation has been detached from the original Section 2-207 and is treated in Sections 2-203(b) and 2-205(a)(1). One looks there to determine whether any contract has been formed. If some contract is formed, the question of what standard terms, if any, are included is treated in new Section 2-206 and revised Section 2-207.

The last clause in Section 2-203(b) deals with contract formation where the parties intend to make a contract but “standard terms” in their records do not otherwise establish (or might prevent the formation of) a contract. The test is taken

from the first sentence of the original Section 2-207(3). Thus, if there is conduct by both parties which recognizes the existence of a contract but standard terms in their records do not agree, a contract is still made under Section 2-203(b).

2. The Drafting Committee concluded that proof of the quantity term after repeal of the statute of frauds, Section 2-201 is subject to Section 2-203(c). The contract is not enforceable beyond the quantity proved. Potential proof sources for the quantity term include trade usage, prior course of dealing and course of performance. If an agreement on quantity cannot be proved, the agreement fails for indefiniteness under Section 2-203(c).

SECTION 2-204. FIRM OFFERS. An offer by a merchant to enter into a contract made in a signed record that by its terms gives assurance that the offer will be held open is not revocable for lack of consideration during the time stated. If no time is stated, the offer is irrevocable for a reasonable time not to exceed three months. A term of assurance in a record supplied by the offeree is ineffective unless it is conspicuous.

SOURCE: Sales, Section 2-205 (December, 1994)

Notes

1. The September 10, 1993 Draft of Section 2-205 provided that if no time is stated in a written firm offer, “the offer is irrevocable for a commercially reasonable time. A motion to restore the original language of Section 2-205, imposing a three month limit, was approved by all of the persons present but was rejected by the Commissioners. Despite the change, the issue is presumably still open.

2. There was no objection to the revision in the last sentence, which substitutes a requirement of conspicuousness for that of “separately signed.

SECTION 2-205. OFFER AND ACCEPTANCE IN FORMATION OF CONTRACT.

(a) Unless otherwise unambiguously indicated by the language or circumstances the following rules apply:

(1) An offer to make a contract must be construed as inviting acceptance in any manner and by any medium reasonable under the circumstances,

including a definite expression of acceptance containing standard terms that vary the terms of the offer.

(2) An order or other offer to buy or acquire goods for prompt or current shipment must be construed as inviting acceptance by a prompt promise to ship or by prompt or current shipment of conforming or nonconforming goods. However, a shipment of nonconforming goods is not an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation.

(b) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

SOURCE: Sales, Section 2-206 (December, 1994)

Notes

1. As noted under Section 2-203, Section 2-203 [formerly Section 2-204] and Section 2-205 [formerly Section 2-206] were revised to state that, in the “battle of the forms,” issues of contract formation are to be separated from questions of what terms become part of the contract. Thus, revised Section 2-203(b) provides that the parties can intend to contract even though the “standard terms in the records of the parties do not otherwise establish a contract” and revised Section 2-205(a) provides that a “definite expression of acceptance” accepts an offer even though it contains “standard terms varying the terms of an offer.” These principles were previously found in Section 2-207(1) and (3) of the 1990 Official Text.

2. The formation test in Section 2-205(a)(1) follows that in the original Section 2-207(1). Unless the offer clearly provides otherwise, a definite acceptance creates a contract even though the acceptance contains standard terms that vary the offer. Unlike the Restatement, Second and Article 19 of CISG, a definite acceptance containing a standard term which materially varies the terms of the offer can create a contract. The offeree can avoid a contract by stating to the offeror that no contract exists unless the offeror agrees to the offeree's standard terms. Presumably, if both parties state that they will not be bound unless the other agrees to their terms, there is no contract unless there is subsequent conduct by both recognizing the existence of a contract.

Language in an offer or purported acceptance which attempts to condition contract formation upon agreement by the other to the terms proposed should be clear and, when contained in a standard form record, be conspicuous.

Here are some examples.

Example #1. After negotiations where no agreement was reached, B sent S an offer in a record [not a standard form] to purchase 1,000 units of described goods at \$500 per unit. The front of the purchase order contained blanks which Buyer filled in and the back contained several standard terms, including an arbitration clause. S sent an acknowledgment the front of which stated “we are pleased to accept your order for 1,000 units at \$500 per unit. The back of the acknowledgment contained a standard term excluding all liability for consequential damages. After the acknowledgment was mailed, S changed its mind (the market price went up) and faxed a rejection to B. There is a contract under Section 2-205(a)(1), which reinforces Section 2-203(a). B clearly accepted the offer and the seller's record did not unambiguously indicate by language or otherwise that there would be no contract unless S agreed to all of the terms proposed, both negotiated and standard. See Section 2-203(d).

The case for a definite expression of acceptance is even clearer if S also shipped the goods before attempting to revoke. There would be no contract, however, if S had said “we are pleased to accept your order at **\$600** per unit” or had clearly and conspicuously indicated that it did not intend to conclude a contract unless B agreed to all of S's terms, both negotiated and standard. See Section 2-203(d). Whether B's arbitration clause or S's exclusion clause are part of the contract depends upon Section 2-207.

Example #2. Suppose, in **Example #1**, that Seller “accepted” Buyer's order for \$600 per unit and the back of the acknowledgment contained a standard term that “seller reserves the right to litigate any dispute. Nevertheless, Seller shipped the goods with the acknowledgment and Buyer accepted them without objection. There is a contract under Section 2-203(b). Since the price term was negotiated, Seller's price of \$600 constituted a counteroffer which Buyer accepted by using the goods. [The usual principles of contract formation apply here.] There was no risk of unfair surprise and B assented without objection by accepting the goods. Which if any of the conflicting standard terms prepared by the parties become part of the contract is determined by Section 2-207.

Example #3. Suppose, in **Example #2**, that Seller accepted Buyer's order for \$500 and shipped the goods which Buyer accepted. Later, there was a dispute, Buyer demanded arbitration and Seller insisted that it had reserved the right to litigate. There is a contract under either Section 2-205(a)(1) or 2-203 despite the different standard terms on dispute resolution. Unless the Buyer's arbitration clause becomes part of the agreement under Section 2-207, the “default” rule is that the seller may litigate.

Example #4. Suppose that standard terms in the records of both parties clearly and conspicuously state that there will be no contract unless their terms are agreed to by the other party. See Section 2-203(d). The seller ships and the buyer accepts the goods. There is a contract under Section 2-203(a) and (b). The agreement of the parties includes non-standard terms in the records of the parties, applicable “default” rules from Part 3 and standard terms incorporated under Section 2-207. See Section 2-207(b).

SECTION 2-206. STANDARD FORM RECORDS.

(a) If all of the terms of a contract are contained in a record which is a standard form or contains standard terms and the party who did not prepare the record manifests assent to it by a signature or other conduct, that party adopts all terms contained in record as part of the contract except those terms that are unconscionable.

(b) A term in a record which is a standard form or which contains standard terms to which a consumer has manifested assent by a signature or other conduct is not part of the contract if the consumer could not reasonably have expected it unless the consumer expressly agrees to the term. In determining whether a term is part of the contract, the court shall consider the content, language, and presentation of the standard form or standard term.

(c) A term adopted under subsection (a) becomes part of the contract without regard to the knowledge or understanding of individual terms by the party assenting to the standard form record, whether or not the party read the form.

SOURCE: Licenses (September, 1994)

Notes

1. This section, which is new, deals with cases where all terms of the contract are contained in a record which is either a standard form as defined in Section 2-102(a)(38) or which contains standard terms. In short, the transaction is highly structured. Section 2-207 deals with cases to which Section 2-206 does not apply, i.e., where there are standard forms or records which contain standard terms but do not contain all of the terms of the contract. These are less structured deals involving two or more records that are exchanged from a distance and pose a greater risk of unfair surprise.

In most cases, the parties will not have agreed to the terms before the standard form or record with standard terms is presented. Thus, the standard form or record is proposed as an offer which can be accepted by conduct or signature. See Sections 2-203 and 2-205. Under Section 2-206(a), however, unless the party who did not prepare the form or record “manifests assent” to the standard form (by conduct, including a signature), the standard terms of the form or record are not part of the contract. To “manifest assent” the party, at a minimum, must have an opportunity to review the terms of the standard form and an opportunity to decline to engage in conduct of assent. Section 2-102(a)(29). “Opportunity to review” is defined in Section 2-102(a)(31). If assent is manifested after an opportunity to review, concerns over unfair surprise are resolved and that party adopts the standard

terms of the form or record unless they are otherwise unconscionable under Section 2-105.

2. At the October, 1995 meeting of the Drafting Committee, Alternative A of the October, 1995 Draft was adopted. Thus, if assent is manifested to a standard form after an opportunity to review it, all of the terms of the standard form are adopted except those that are unconscionable. Alternatives B and C in the October, 1995 Draft, which excluded certain terms under circumstances where the party submitting the form should have called them to the attention of the assenting party but failed to do so, were rejected. Subsequent changes are designed to clarify the scope and effect of Section 2-206.

3. Subsection (b) provides a different rule for consumers. The question is not what the provider should have disclosed but what the consumer should have reasonably expected. If the term is within the consumer's reasonable expectations it is included. If the term is beyond those reasonable expectations it is not adopted unless the consumer "expressly agreed to it. This subsection is under review by the Consumer Subcommittee.

4. For background, Section 2-206 modifies the December, 1994 Draft based on the discussions of the Drafting Committee. Alternative A received substantial support at the January, 1995 meeting. Alternative B stems from Section 2-2203 (Licenses). Alternative C follows Section 211(c) of the Restatement, Second except that the party is not required to expect the regular use of such forms. Subsection (b), which provides a special rule for consumers, is based upon UNIDROIT Article 2.20.

6. Some Illustrations:

Seller drafts a clause excluding all liability for consequential damages and includes it in a record prepared by Seller. The record contains other terms. Buyer receives and signs the record. The goods do not conform to the contract and Buyer suffers consequential damages.

(1) If the exclusion clause is neither contained in a standard form nor is a standard term, Sections 2-206 and 2-207 do not apply. Buyer is bound by its assent to the record. Put differently, Buyer is solely responsible for reading and understanding the clause before assent.

(2) If the exclusion clause is a standard term contained in a standard form or record which contains all of the terms of the contract, Buyer is not bound unless it "manifests assent" as that term is defined in Section 2-102(a)(29). Section 2-206(a). This offers some minimal protection against unfair surprise. On the other hand, if Seller and Buyer negotiated the exclusion clause, the term is no longer a standard term and Section 2-206(a) does not apply.

(3) If the exclusion clause is a standard term contained in a record that is not a standard form and Buyer signs that record, Section 2-206(a) determines whether it becomes part of the contract. On the other hand, if the seller and buyer negotiate the exclusion clause, it is not a standard term and Section 2-207 does not apply.

SECTION 2-207. EFFECT OF VARYING STANDARD TERMS.

(a) In a contract to which Section 2-206 does not apply, standard terms in a record prepared by one party that materially vary the contract are not part of the contract unless the party claiming inclusion establishes that the other party:

(1) expressly agreed to them; or

(2) had reason to know of them from course of performance, course of dealing or usage of trade and that they were intended for inclusion in the contract.

(b) In cases governed by subsection (a), the terms of the contract are:

(1) standard terms included under subsection (a);

(2) other terms to which the parties have agreed, whether or not contained in a record; and

(3) supplementary terms incorporated under any other provision of this [article].

SOURCE: Sales, Section 2-207 (December, 1994, March, 1995)

Notes

1. The original Section 2-207 was both an exception to the common law “duty to read” principle and a particularized application in commercial cases of the unconscionability doctrine in Section 2-302. In practice it applied to determine if there was some contract for sale when the writings of the parties were in conflict and, if so, what terms in the writings of the parties became part of the contract. The objective was to neutralize any strategic advantage gained where standard terms were used (although Section 2-207 was not limited to standard terms) and to reduce the risk of unfair surprise where one party apparently agreed (assented by conduct) to standard terms which had not been read or understood. The assumption was that even in commercial transactions the risk of unfair surprise requires special rules where standard terms are involved. More particularly, it assumes that commercial parties in unstructured transactions [i.e., no record containing all the terms of the contract] do not have a realistic opportunity to review the standard terms of the other before manifesting assent.

2. Initially, two versions of Section 2-207 were drafted. The first followed Section 2-207 in the 1990 Official Text and attempted to amplify and clarify it in light of apparent objectives, academic commentary, and judicial decisions. The second developed a simplified structure that focused on the unfair surprise issue. Assuming that some contract was formed under Sections 2-203 and 2-205, the sole question was whether “varying terms” became part of the contract. At the October 1-3, 1993 meeting, the Drafting Committee approved the approach of the second

version of Section 2-207. A first effort to implement that objective was made in the May, 1994 Draft, where the key concept, “varying terms,” was defined in Section 2-207(a). Drawing on the September, 1994 Draft of the Licenses article, the December 20, 1994 Draft of Article 2 added a new section on “standard form agreements” and defined such terms as “standard form” and “standard terms” in Part 1. These sections provided a direct response to recurring questions raised in standard form contracting. Relying on new Section 2-206, covering “Standard Form Agreements,” and the new definitions to do deal with most unfair surprise and advantage taking, the May, 1995 Draft of Section 2-207 was limited to “conflicting standard terms, i.e., terms which vary other terms by adding to or contradicting them.

3. In October, 1995 the Drafting Committee decided to limit Section 2-206 to cases where all of the agreement was contained in a standard form or a record containing standard terms. Section 2-207, therefore, has been reworked to deal with the unstructured, partially negotiated transaction where standard terms are contained in the records of one or both parties. Revised Section 2-207 (January, 1996) operates as follows:

First, it assumes a contract for sale has been formed under Sections 2-203 and 2-205. Section 2-207 does not deal with contract formation. It also assumes that there will be an agreement between the parties on terms other than standard terms.

Second, Section 2-206, where all of the terms are contained in a standard form or a record containing standard terms, does not apply. If it applies, Section 2-207 does not.

Third, Section 2-207 applies where one or both parties use standard terms in records which add to or differ materially from [vary] the terms [standard terms, negotiated terms or terms supplied by Article] in the agreement between them. To have a contract there must be some agreement. Section 2-207 deals with the narrow question whether the standard terms of one or both parties are part of that agreement.

Fourth, the purpose of Section 2-207 is still to minimize unfair surprise and “first” and “last” shot advantage taking where one party seeks to include a standard term which varies terms in the agreement. Key definitions are “term,” Section 1-201(42), and “standard terms,” Section 2-102(a)(39). The phrase “varying terms,” although not defined, includes standard terms which materially add to or are different from the agreement of the parties.

Fifth, the need for Section 2-207 arises because the party against whom the standard terms operate has apparently agreed to them by conduct [not “manifested assent,” Section 2-102(a)(29)] under circumstances where there is no realistic opportunity to review. Unlike the Section 2-206 case where all terms are in a standard form or record with standard terms, there is no assurance that a seller or a buyer will (or even “should”) take time to read and understand the “boilerplate.” Thus, a special test to validate apparent assent is required. Moreover, more than a simple awareness of the standard terms may be required. In the absence of express agreement, the other party should also understand that the party seeking inclusion intended the standard terms to be part of the contract. This follows Judge

Wisdom's well reasoned opinion in *Step-Saver Data Sys. v. Wyse Technology*, 939 F.2d 91, 102-103 (3d Cir. 1991) (“shrink wrap license”).

Illustrations

A. All terms expressed in one record that is not a standard form. In many cases, all of the terms of the contract are contained in one record to which both parties have assented, usually by signature. If that record is not a standard form or contains standard terms, Section 2-206 does not apply. If some of the terms are standard terms, Section 2-206 does apply because the risk of unfair surprise and advantage taking is low. If all of the terms, both negotiated and standard, are in one record, a party who manifests assent to that record is bound.

B. All terms expressed in one standard form record. Section 2-206 applies here. Since substantially all of the terms are standard terms and none are negotiated, the assenting party must have an opportunity to review before manifesting assent.

C. Standard terms in the record of only one party.

Consider two cases to which Section 2-207 applies:

First, after negotiations, Seller sends an offer in a record which contains a standard term arbitration clause. Buyer accepts in a record which contains no standard terms. Later, Seller initiates arbitration under a standard term in its offer. There is a contract under Section 2-203(a). Whether the arbitration clause is part of the agreement (the “first shot”) is determined under Section 2-207(a).

Second, after negotiations, Buyer sends an offer in a record which contains no standard terms. Seller makes a definite acceptance in a record which contains standard terms, one of which excludes any liability for consequential damages and another of which states a method of payment. The goods, which Seller shipped and Buyer accepted, are unmerchantable and Buyer suffers consequential damages. There is a contract under Section 2-205(a)(1). Whether the exclusion clause is part of the contract (the “last shot”) is again determined under Section 2-207(a). Here the buyer's conduct in accepting the goods without objection apparently agrees to the standard term but that terms is not included unless Section 2-206(a) is satisfied.

Note in both cases the party against whom the standard term was asserted had, by conduct, apparently agreed to the term. But unless that assent is of the quality required in Section 2-207(a), the standard term is not part of the contract.

C. Standard terms in records of both parties. In transactions at a distance where the records of both parties contain standard terms, the risk of unfair surprise and strategic advantage is probably the highest. The agents who handle these transactions rarely take the opportunity to review the forms and this reality is well understood by all. Thus, both parties can include advantageous standard terms and know that the other party won't read it and will probably manifest a blanket assent to all terms without objection.

Consider these cases.

(1) After negotiations, Buyer orders 1,000 units of goods at \$50 per unit in a record which contains standard terms. Seller sends an acknowledgment “accepting the offer and promising to send 900 units in a record which contains standard terms. Before the acknowledgment arrives, Seller sells the goods to a third person for \$65 a unit. Unless Section 2-205(a)(2) applies, the purported acceptance was a counteroffer when it is received by Buyer and, thus, a rejection of the offer. The “mirror image” rule still applies where the offer is varied by negotiated rather than standard terms. See Section 2-205(a)(1). No question whether standard terms are part of the contract is raised.

(2) After negotiations, Buyer sends an offer to buy 1000 units at \$50 per unit in a record which contains a standard term arbitration clause. Seller sends an acknowledgment accepting the offer in a record which contains a standard term warranty disclaimer. Seller then ships and Buyer accepts the goods. Neither object to the other's standard terms. Later, Buyer discovers that the goods are unmerchantable and initiates arbitration. Seller denies that it agreed to arbitrate and claims that all implied warranties were disclaimed. There is a contract. Whether either the arbitration clause or the disclaimer are part of the contract depends upon what either party is able to establish under Section 2-207(a).

(4) Suppose the records of both parties contained standard term arbitration clauses which differed in material ways. For example, Buyer's clause might agree to arbitrate “all disputes arising out of or relating to the contract and Seller clause might agree to arbitrate all disputes “except breach of warranty claims. Here the standard terms conflict. Under Section 2-207 neither clause becomes part of the contract unless subsection (a) is satisfied. But there is no automatic “knockout. It is possible, for example, that one or both of the standard term arbitration terms will be expressly agreed to by one of the parties. If so, it becomes part of the agreement and subject to the process of contract interpretation.

The same analysis applies if the records contained standard term arbitration clauses which agreed in substance. Suppose they differed only in the time within which a demand for arbitration must be made. Nevertheless, both materially vary the terms of the agreement [the “default” rule is no arbitration] and neither is part of the contract unless Section 2-207(a) is satisfied.

D. Standard terms in records confirming prior oral agreements.

Suppose Seller and Buyer reach an oral contract or a contract for sale through “informal” correspondence. Later, Seller sends a signed record confirming and containing standard terms that vary the prior oral agreement. What is the effect of the standard terms?

Original Section 2-207(1) provided that a “written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those ... agreed upon. Thus, the confirmation was treated as an acceptance rather than a proposal to modify the contract and the additional or different terms became part of the contract only if Section 2-207(2) was satisfied. The problem was complicated where an earlier oral agreement was unenforceable under the statute of frauds and the writing both satisfied the statute between merchants, see Section 2-202(2), and proposed additional or different terms. Furthermore, a confirmation proposing additional or different terms and

expressly conditioning the contract upon agreement to them was probably a repudiation rather than an acceptance or a proposal for modification.

Revised Article 2 solves the problem without specifically identifying it.

First, the statute of frauds is repealed.

Second, whether the oral or informal agreement is a contract is decided under Sections 2-203 and 2-205.

Third, if there is a contract whether the standard terms in a confirmation become part of the agreement depends upon Section 2-207.

Fourth, if the record proposes a modification and the terms are included under Section 2-207(a), whether the modification is enforceable is determined by Section 2-210.

Finally, whether the record is a repudiation rather than a proposed modification is determined by Section 2-613.

In sum, revised Sections 2-203, 2-205, and 2-207 and new Section 2-206 focus on two questions that were implicit in the original Section 2-207. First, when does the presence of standard terms in the records of one or both parties prevent contract formation achieved under other principles? Second, if some contract is formed, when do the standard terms become part of the agreement?

SECTION 2-208. ELECTRONIC TRANSACTIONS: FORMATION.

(a) In an electronic transaction, if an electronic message initiated by one party evokes an electronic message or other electronic response by the other or its electronic agent, a contract is created when the initiating party receives a message manifesting acceptance.

(b) A contract is created under subsection (a) even if no individual representing either party was aware of or reviewed the initial message or response or the action manifesting acceptance of the contract. Electronic records exchanged in an electronic transaction are effective when received in a form and at a location capable of processing the record even if no individual is aware of their receipt.

(c) In determining when an electronic message sent to another party is received by that party, the following rules apply:

(1) If the recipient of the message, whether or not recorded, has designated an information system for the purpose of receiving such messages, receipt occurs when the message enters the designated information system.

(2) If the intended recipient has not designated an information system for receipt of electronic records, receipt occurs when the record enters any information system of the intended recipient.

SOURCE: Licenses, Section 2-2202 (September, 1994); UNCITRAL, Model Law on EDI

Notes

This section is new and has not been discussed by the Drafting Committee or conformed to Section 2B-205 (Feb. 1996). It is part of a cluster of new definitions and sections designed to deal with EDI transactions.

SECTION 2-209. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.

(a) If a contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other party, a course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the agreement.

(b) Express terms of an agreement, course of performance, course of dealing and usage of trade must be construed, if reasonable, as consistent with each other. However, if that construction is unreasonable, express terms prevail over course of performance, course of dealing, and usage of trade and course of performance prevail over both course of dealing and usage of trade.

(c) Subject to Section 2-210, course of performance is relevant to show a waiver or modification of a term inconsistent with the course of performance.

SOURCE: Sales, Section 2-209 (December, 1994)

Notes

See Section 2B-302 (Feb. 1996). The ABA UCC Article 1 Review Task Force has redrafted Section 1-205 to incorporate the provisions of Section 2-209. If this revision is approved, there will be no need for Section 2-208 in Article 2. There appears to be general support for this proposed move.

SECTION 2-210. MODIFICATION, RESCISSION, AND WAIVER.

(a) A good-faith agreement modifying a contract under this [article] is binding without consideration.

(b) Except in a consumer contract or as otherwise provided in subsection (c), a contract that contains a term prohibiting modification or rescission except by a signed record may not be otherwise modified or rescinded.

(c) A party whose language or conduct in modifying or rescinding a contract is inconsistent with a term requiring a signed record to modify or rescind the contract may not assert the term if the other party is induced to change its position reasonably and in good faith.

(d) Subject to subsection (c), a contract term may be modified or rescinded by waiver. Language or a course of performance between the parties is relevant to show a waiver of any term inconsistent with that language or course of performance. The waiver of an executory portion of a contract may be retracted by reasonable notification received by the other party that strict performance is required of any term waived unless the waiver induced the other party to change its position reasonably and in good faith.

SOURCE: Sales, Section 2-209 (December, 1994)

Notes

1. There are several changes in revised Section 2-210 [formerly Section 2-209 of the 1990 Official Text].

First, the requirement of a good faith agreement to modify, previously found in a Comment, is explicitly stated in subsection (a). This follows the cases, see, e.g., *Roth Steel Products v. Sharon Steel Corp.*, 705 F.2d 134 (6th Cir. 1983), and avoids the argument that a contract modification is neither the “performance or

enforcement of a contract under Section 1-203. This revision is rejected in Section 2B-303, Note 3.

Second, the section is revised to reflect the repeal of the statute of frauds. Except in a consumer contract, however, the parties may agree that a signed record is required to modify or rescind the contract. See subsection (b). See Section 2B-303(b), which uses the phrase “authenticated record.

Third, it is clearer when a “no oral modification” clause can be waived by the party for whose benefit it was intended, subsection (c). Similarly, subsection (d) clarifies the nature and effect of waiver when other terms of the contract are involved. Thus, the party for whose benefit a term is required can waive it by electing not to insist on it at an appropriate time or by inducing reliance in the other party by representing that a term will not be insisted on at a future time. These revisions are rejected in Section 2B-303.

2. Except in Consumer Contracts, subsection (b) validates “no oral modification” terms in contracts for sale. In other cases, the normal rules of modification and rescission apply, including agreed modifications under subsection (1). In the original Section 2-209(2), the NOM clause was valid in all transactions, with the requirement that a form containing the NOM clause supplied by a merchant had to be separately signed by a non-merchant. The Drafting Committee excluded Consumer Contracts from NOM clauses and deleted the “separately signed” clause, leaving commercial parties who are not merchants to fend for themselves.

3. Subsection (c) provides that a NOM clause, a contract condition, may be waived in certain circumstances by the party for whose benefit it was included, provided that the words or conduct of waiver are inconsistent with the NOM clause and induce reasonable, good faith reliance. Reliance is required whether the language of waiver is part of or independent from an agreement with the other party. Compare Restatement, Second, Contracts § 139. This revision is rejected in Section 2B-303.

To illustrate, suppose the contract contains a NOM clause and a schedule for installment deliveries by the seller. The seller encounters production problems, misses a due date and requests an extension of delivery time from the buyer. First, suppose the buyer states that it will not insist on the NOM condition and orally agrees to a time extension. The seller does not request a written modification and proceeds to deliver under the modified schedule. Later, the seller invokes the NOM clause and sues for damages caused by late delivery. Here, the NOM clause is waived under subsection (c) by express, inconsistent language which induced reasonable, good faith reliance and the agreed modification is enforceable under subsection (a). The modification of the delivery schedule is enforceable under Section 2-209(a). Second, suppose the buyer states that the late delivery is excused and orally agrees to a time extension. The seller, without obtaining a written modification, proceeds under the modified schedule. Later, the buyer invokes the NOM clause and sues the seller for damages arising from late delivery. Once again, the NOM clause was waived under subsection (c), this time by the buyer’s “language and conduct in effecting a modification ... is inconsistent with the term and induces the other party to change its position reasonably and in good faith.

Although a party may waive one late installment, an agreement to modify the time of future deliveries is not necessarily enforceable. It must be either a “good faith” agreement under subsection (a) or induce reasonable, good faith reliance under subsection (d). The doctrine of waiver is not available to create or modify agreed duties under the contract.

4. Subsection (d) recognizes the general principle of waiver where NOM clauses are not involved. There are three types. In the first, called election waiver, the party for whose benefit a condition is included elects not to insist upon the condition after the time for its occurrence has passed. The condition is excused without a need to prove reliance by the other party. Election waiver is included in the first sentence of subsection (d). In the second, called reliance waiver, the party for whose benefit a condition is included states that he will not insist upon the occurrence of a condition in the future. Here, however, the waiver may be retracted unless the other party has changed its position “reasonably and good faith. Subsection (d), last sentence. In the third, the court simply excuses the condition when its nonoccurrence would cause “disproportionate forfeiture” and the occurrence of the condition was not a “material part of the agreed exchange. Restatement, Second, Contracts § 229. See *Aetna Casualty and Surety Co. v. Murphy*, 538 A.2d 219 (Conn. 1988) (burden on party seeking excuse to prove that condition was not a material part of exchange).

SECTION 2-211. DELEGATION OF PERFORMANCE. A party may delegate to another its performance under a contract for sale unless the other party to the contract has a substantial interest in having the original promisor perform or directly control the performance required by the contract or the contract prohibits delegation. A delegation of performance does not relieve the delegating party of any duty to perform or liability for breach.

SOURCE: Sales, Section 2-210(a) (December, 1994); Licenses, Section 2-2304 (September, 1994)

Notes

1. This section has not been conformed to Section 9-318(4) or Section 2A-303.

2. The original language of Section 2-210(4) has been restored. The May, 1994 Draft stated that acceptance of a “delegation of duties” rather than acceptance of the “assignment” constituted a promise to perform duties under the contract. Arguably, this unduly narrows and complicates the legal effect of accepting the transfer of a contract where rights are assigned and duties are delegated.

SECTION 2-212. ELECTRONIC MESSAGES; ATTRIBUTION. If an electronic message is sent to another party, as between the party indicated in the message as the initiating party and the party receiving the message, the party described as the initiating party is bound by the terms of the message if:

(1) the message was sent by that party or a person who had authority to act on behalf of that party in reference to such messages;

(2) by properly applying a procedure previously agreed to by the parties for purposes of authentication, the recipient concluded that the message was originated by, or otherwise attributable to, the initiating party; or

(3) the message as received resulted from actions of a person whose relationship with the party described as the initiating party enabled that person to gain access to and use the method employed by the alleged initiating party to identify data messages as its own.

SOURCE: UNCITRAL Draft Model Law on EDI

SECTION 2-213. INTERMEDIARIES IN ELECTRONIC MESSAGES.

(a) If a party engages an intermediary to perform services, such as the transmission, logging, or processing of data, the party who engages the intermediary is liable for any damage arising directly from that intermediary's acts, errors, or omissions in the performance of those services.

(b) If a party sends an electronic message through or with the assistance of an intermediary that provides transmission or similar services, the party who sends that message is bound by the terms of the message as received notwithstanding errors in the transmission, unless the party receiving the message should have discovered the error by the exercise of care reasonable under the circumstances or

the receiving party failed to employ a verification or authentication system agreed to by the parties before the transmission.

SOURCE: UNCITRAL Draft Model Law on EDI

Notes

Sections 2-212 and 2-213 have not been reviewed by the Drafting Committee. See Sections 2B-321 through 323.

PART 3
GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

SECTION 2-301. HOW PRICE PAYABLE.

- (a) The price may be made payable in money or otherwise.
- (b) If the price is payable in whole or in part in goods, each transferor is a seller with respect to the goods transferred for purposes of this [article].
- (c) The sale of goods and related obligations are subject to this [article] even if all or part of the price is payable in an interest in realty. This [article] applies to the transfer of goods but not to the transfer of an interest in realty.

SOURCE: Section 2-304 (December, 1994)

Notes

There are no substantive changes in former Section 2-304. The phrase “and related obligations” in subsection (c) refers to a term in a contract for sale or collateral contract obligating the seller to install, customize, service, repair or replace the goods. See Section 2-103(a)(3).

SECTION 2-302. TRANSFER AT SINGLE TIME.

- (a) If all of one party's performance can be rendered at one time, the performance is due at one time and payment or other reciprocal performance is due only on tender of full performance.
- (b) If circumstances give either party the right to make or demand performance in parts or over a period of time, payment, if it can be apportioned, may be demanded for each part performance unless the agreement or the circumstances indicate to the contrary.
- (c) If payment cannot be apportioned or the agreement or the circumstances indicate that payment may not be demanded for part performance, payment is due on completion of the full performance.

SOURCE: Licenses, Section 2-2214 (September, 1994)

Notes

1. This revision of former Section 2-307 clarifies when a party's performance is due at one time and what the other party's duties are on full performance. It also states when, in the absence of an agreed installment contract, a part performance is permitted and how payment is to be apportioned. Except for covering the obligations of both seller and buyer, no changes of substance are intended.

2. The factors justifying delivery in more than a single lot include the type of disruptive circumstances, the alternatives reasonably available and the understanding that the parties will make up any deficiencies within a reasonable time. Thus, if the seller agreed to deliver 10 carloads and, because of a railroad strike, only three cars were available at the time of delivery and the cost of alternative transportation was high, the seller is probably obligated to tender three carloads. Assuming reasonable efforts, the balance is due as cars become available.

This section should be distinguished from Section 2-616, which deals with excuse and substitute performance when changed circumstances disrupt agreed methods of shipment, delivery or payment. Presumably, it takes less disruption to vary a "default" rule than to excuse an agreed performance.

3. The operation of Section 2-302 creates an installment contract, i.e., goods delivered "in separate lots to be separately accepted." Section 2-611(1). But it is not a credit installment contract: payment for each lot is due upon tender. This makes sense if payment for the single lot was due upon tender. But suppose the contract said nothing about the quantity to be delivered and the parties agreed upon 30 days credit. If circumstances justify delivery in lots, is payment for each lot due 30 days after delivery or must payment be made upon tender? The answer, although not clear, should be that the agreed credit term survives and payment is not due until all of the goods are tendered. Only the "default" rule is altered by circumstances.

4. Clearly, the installment contract created by Section 2-302 is by operation of law. It in no way interferes with the parties's power to create by agreement an installment contract where payment is due after the goods are tendered and accepted.

SECTION 2-303. OPEN CONTRACT PRICE TERM.

(a) The parties, if they so intend, may conclude a contract for sale even if the contract price is not agreed upon. In that case, the contract price is a reasonable price at the time that the seller is to complete its initial delivery if:

(1) nothing is agreed as to contract price;

(2) the contract price is left to be agreed by the parties and they fail to agree; or

(3) the contract price is to be fixed in terms of some agreed market or other standard as set or recorded by a third party or agency and it is not so set or recorded.

(b) A price to be fixed by the seller or the buyer means a contract price to be fixed in good faith.

(c) If a contract price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party, the other party at that party's option may treat the contract as canceled or may fix a reasonable price.

(d) If the parties intend not to be bound unless the contract price is fixed or agreed and it is not fixed or agreed to, there is no contract. In that case, the buyer shall return any goods already received or, if unable to do so, pay their reasonable value at the time of transfer. The seller is obligated to return any portion of the contract price paid on account.

SOURCE: Licenses, Section 2-2210 (September, 1994); Sales, Section 2-305 (December, 1994)

Notes

There are no revisions in former Section 2-305.

SECTION 2-304. OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALINGS.

(a) A term that measures the quantity of goods by the output of the seller or the requirements of the buyer means the actual output or requirements as may occur in good faith. If actual output or requirements occur in good faith, a quantity unreasonably disproportionate to any stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements, may not be offered or demanded.

(b) An agreement by a seller or buyer for exclusive dealing in the kind of goods concerned imposes 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.

Notes

1. Section 2-304(a) has several objectives.

First, it states the meaning of “output” and “requirements” terms when used in a contract for sale. Such terms do not cause a contract to fail for indefiniteness. See Section 2-203(c). The parties may agree upon a fixed quantity or no quantity or something in between. But unless the parties agree to measure all or part of the quantity by “output” or “requirements,” Section 2-304(a) does not apply.

Second, it imposes a duty of good faith on the exercise of discretion by either party to determine the level of output or requirements. Section 2-306(a), however, does not say whether there must also be an exclusive dealing arrangement before an output or requirements term is enforceable. Although some states require exclusive dealing, see *Essco Geometric v. Harvard Industries*, 46 F.3d 718 (8th Cir. 1995) (Missouri law), this is a bit extreme. The term should be enforceable where the seller or buyer agrees to supply or demand all **or part** of its output or requirements to or from the other. See *Advent Systems Ltd. v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991) (non-exclusive requirements term satisfies statute of frauds). For example, a term where the buyer agrees to buy 10% of its actual requirements in good faith from the seller should be enforceable. On the other hand, the buyer would not have the additional obligation to use “best efforts” unless there were an exclusive dealing contract. Section 2-306(2). See *Tigg Corp. v. Dow Corning Corp.*, 962 F.2d 1119 (3d Cir. 1992).

Third, it clarifies that if there are no actual output or requirements in good faith, the party has no duty to perform even though there are estimates in the contract or there were prior output or requirements. The question is whether the lack of output or requirements occurred in good faith, not whether the lack of actual output or requirements was “unreasonably disproportionate.” This follows the interpretation of prior Section 2-306(1) in *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988), but rejects the court's dictum that the unreasonably disproportionate limitation is not applicable to any decrease in quantity or requirements. See also, *Tigg Corp. v. Dow Corning Corp.*, 962 F.2d 1119 (3d Cir. 1992). The California State Bar, however, disagrees with this clarification, believing that the “yardstick for output and requirements contracts should be prior output or shared estimates, not actual output or requirements.

Fourth, the question when a party with no actual output or requirements has acted in good faith is more difficult to answer. Some courts have drawn the line between decisions made because the contract is simply unprofitable or too costly (bad faith) and those made because an event external to the contract has adversely affected the viability of the entire enterprise (good faith). The traditional definitions of good faith, see Section 2-103(1)(b) of the 1990 Official Text, do not clearly respond to this problem. At least one court has held, however, that bad faith

is established if the party claiming no actual requirements fails to offer a reason for that situation. See Empire Gas Corp., *supra*.

Fifth, in cases where there are some actual output or requirements in good faith, Section 2-304(a) further controls the exercise of discretion by requiring a reasonable proportion between agreed estimates or prior comparable output or requirements and the goods actually supplied or ordered. Suppose, for example, that the buyer estimated its requirements to be 50,000 units per year. Over a five year period, the buyer's orders averaged between 45,000 to 55,000 per year. In the 6th year, buyer's actual requirements in good faith were 80,000 per year. If 80,000 units were ordered, the question is whether the quantity is "unreasonably disproportionate" to the stated estimate and this question is answered more by whether the variations were reasonably foreseeable at the time of the contract than the motives of the buyer or seller. See *Orange & Rockland v. Amerada Hess Corp.*, 397 N.Y.S.2d 814 (N.Y.A.D. 1977). See also, *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, ___ S.W.2d. ___, 27 UCC Rep.Serv.2d 1 (Texas 1995) (actual output in good faith may still be unreasonably disproportionate to estimates or prior performance).

2. Section 2-304(b) deals with an exclusive dealing agreement in a contract where the requirements of a buyer depend upon the resale market demand for them. Unless otherwise agreed, the seller must use "best efforts" to supply those requirements. On the other hand, if the buyer has X requirements in good faith, the seller can insist that the buyer use "best efforts to promote their sale." Actual requirements in good faith are not enough.

SECTION 2-305. ABSENCE OF SPECIFIED PLACE FOR DELIVERY.

(a) The place for delivery of goods is the seller's place of business or, if there is none, the seller's residence.

(b) In a contract for sale of identified goods that to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery.

(c) Documents of title may be delivered through customary banking channels.

SOURCE: Sales, Section 2-308 (December, 1994)

Notes

There are no revisions of substance in former Section 2-308.

SECTION 2-306. TIME FOR PERFORMANCE NOT SPECIFIED.

(a) Except as otherwise provided in this [article], the time for performance or any other action under a contract is a reasonable time.

(b) An agreement that provides for successive performances but is indefinite in duration is valid for a reasonable time. Subject to Section 2-311, either party may terminate the contract at any time.

SOURCE: Sales, Section 2-309(a)(b) (December, 1994)

Notes

1. Section 2-306 adopts without change the provisions for time and duration of performance found in Section 2-309(a) and (b) of the December, 1994 Draft. Termination of the contract, previously covered in Section 2-309(c), is now covered in Section 2-311.

2. The basic “gap filler” for time is a “reasonable time,” defined in Section 1-204(2). Where the statute requires action to be taken within a reasonable time, however, “any time which is not manifestly unreasonable may be fixed by agreement.” Section 1-204(1).

3. If the agreement is for “successive performances” but is indefinite in duration, the duration is a reasonable time. Subsection (b). The contract, however, is terminable at will by either party, subject to the notice requirement in Section 2-311(a).

SECTION 2-307. OPTIONS AND COOPERATION RESPECTING PERFORMANCE.

(a) An agreement that is otherwise sufficiently definite to be a contract is not unenforceable merely because it leaves particulars of performance to be specified by one of the parties.

(b) If one party is required to specify the particulars of performance, the specification must be made in good faith and within limits set by commercial reasonableness.

(c) A contract providing that the performance of the seller be to the satisfaction of the buyer without further specifying the standard of performance

requires that the performance be such that a reasonable person in the position of the buyer would be satisfied.

(d) A specification relating to assortment of goods is at the buyer's option. Except as otherwise provided in subsection (e), a specification or arrangement relating to shipment is at the buyer's option.

(e) If a specification by one party would materially affect the other party's performance but it is not seasonably made or one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party, in addition to all other remedies:

(1) is excused for any resulting delay in the party's performance; and

(2) may proceed to perform in any reasonable manner or, after the time for a material part of the party's own performance, treat the failure to specify or cooperate as a breach.

SOURCE: Licenses, Section 2-2219 (September, 1994); Sales, Section 2-311 (December, 1994)

SECTION 2-308. "LETTER OF CREDIT"; "CONFIRMED CREDIT."

(a) Failure of a party seasonably to furnish an agreed letter of credit intended as the primary method of payment is a breach of a contract for sale.

(b) Delivery to a seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller on seasonable notification, may require payment directly from the buyer.

(c) The term "letter of credit" or "banker's credit" in a contract means an irrevocable definite undertaking as defined in Section 5-102(a)(10) issued by a financing agency of good repute and, if the shipment is overseas, of good international repute.

Notes

Section 2-308, formerly Section 2-325 of the 1990 Official Text, states the effect of supplying or failing to supply an agreed letter of credit. Letter of credit is defined with reference to Section 5-102(a)(10) of the 1995 Official Text. All other aspects of the letter of credit transaction are covered by revised Article 5.

SECTION 2-309. SHIPMENT TERMS; SOURCE OF MEANING. The effect of a party's use of shipment terms such as FOB, CIF, or the like, must be interpreted in light of applicable usage of the trade and any course of dealing or performance between the parties. If such usage or course of dealing or performance is not shown, the meaning of shipment terms used in a contract may be interpreted by reference to the Incoterms as published by the International Chamber of Commerce.

SOURCE: Licenses (September, 1994)

Notes

1. In the May, 1994 Draft, Sections 2-319 through 2-324, dealing with shipment and delivery terms, were deleted. The conclusion was that these terms were out of date with current practice.

Section 2-309 is a first step toward filling the gap on delivery terms. If the meaning of a stated shipment or delivery term cannot be found in the agreement or an applicable usage of trade, the meaning may be determined by reference of the Incoterms of the International Chamber of Commerce.

SECTION 2-310. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Subject to subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged.

(b) The following survive termination of a contract:

(1) a right based on breach or performance before termination; and

(2) a limitation on the scope, manner, method, or location of the exercise of rights in the goods.

SOURCE: Licenses, Section 2-2218 (September, 1994)

Notes

Section 2-310 states what obligations survive a termination. See former Section 2-106(4). “Termination is defined as an act which ends a contract for other than breach. See Section 2-102(a)(48).

SECTION 2-311. TERMINATION; NOTICE.

(a) A party may not terminate a contract, except on the happening of an agreed event, unless the other party receives reasonable notification of the termination.

(b) An agreement dispensing with notification is invalid if its operation is unconscionable. However, an agreement specifying standards on the nature and timing of notice is enforceable if the standards are not manifestly unreasonable.

SOURCE: Sales, Section 2-309(c) (December, 1994)

Notes

1. Assuming that a party has power to terminate the contract, Section 2-311(a) states when notice is a condition precedent to termination and subsection (b) limits agreements attempting to dispense with the notice requirement. See former Section 2-309(3). In short, the power to terminate at will is conditioned upon the receipt by the other party of “reasonable notification, which, in turn, “depends on the nature, purpose and circumstances of such action. Section 1-204(2).

2. The “reasonable notification condition in subsection (c) refers to the time after which notice is received before the termination is effective. In short, the other party must be given a “reasonable time to exit from the contract.

There are three exceptions to this important default rule. First, notice is not required if the contract provides that termination will occur on the “happening of an agreed event. For example, if the parties in a requirements contract agree that the contract is terminated if the buyer has no actual requirements in good faith, a termination notice is not required. Second, the parties can agree on what is reasonable notification, if the agreement is not “manifestly unreasonable. Section 1-204(1). Franchise and distributorship contracts typically provide for 30, 60 or 90 days notice and the courts have generally upheld such time provisions as reasonable. Finally, the parties can agree to dispense with notification, unless the “operation of that agreement “is unconscionable.

The last two limitations relate to the other party's investment in the contract and the opportunity to salvage and reinvest after termination. Thus, if the contract investment is substantial and the reinvestment process is difficult, the more likely it is that, say, an agreed 10 day notice is unreasonable or that an agreement dispensing with notice operates in an unconscionable manner. The assumption is that except

for part performance under the contract, the terminated party assumes the financial risk of a proper termination.

3. Without more, the exercise of an agreed power to terminate is also subject to the duty of good faith, Section 1-203, which cannot be disclaimed by agreement. Section 1-102(3). Most courts, however, have found good faith where the terminating party follows the terms of the agreement. Under this approach, the motive of the terminating party is irrelevant and the agreed termination is effective if a reasonable notice is given. In light of express concerns about this issue [e.g., the State Bar of California], perhaps some clarification is required.

SECTION 2-312. WARRANTY OF TITLE AND AGAINST INFRINGEMENT; BUYER'S OBLIGATION AGAINST INFRINGEMENT.

(a) Subject to subsection (b), a contract for sale contains a warranty by a seller, including an auctioneer or liquidator who fails to disclose its principal, that:

(1) the title conveyed is good and uncontested and its transfer is rightful and does not unreasonably expose the buyer to a lawsuit; and

(2) the goods will be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting does not have knowledge.

(b) A warranty under subsection (a) may be excluded or modified only by specific language or by circumstances giving the buyer reason to know that the seller does not claim title or purports to sell only such right or title as the seller or a third party may have. Language in a record is sufficient to exclude warranties under this section if it is conspicuous and states "There is no warranty of title or against infringement in this sale, or words of similar import.

(c) Unless otherwise agreed, a seller who deals in goods of the kind sold warrants that the goods will be delivered free of the rightful claim of a third party by way of infringement or the like. However, a buyer who furnishes specifications to the seller holds the seller harmless against any claim that arises out of compliance with the specifications.

(d) A seller's warranty of title, made to an immediate buyer, extends to any remote buyer who may reasonably be expected to buy the goods and who suffers damage from breach of the warranty. The rights and remedies of a remote buyer against the seller for breach of warranty are determined by the enforceable terms of the contract between the seller and the immediate buyer and this [article].

SOURCE: Sales, Section 2-312 (March, 1995)

Notes

1. Subsection (a) defines seller to include an “auctioneer or liquidator who fail to disclose its principal. See *Jones v. Ballard*, 573 So.2d 783 (Miss. 1990). There is no requirement that the auctioneer or liquidator reveal the name of its principal.

2. In addition to warranting that the “title conveyed is good and its transfer rightful, see *Sumner v. Fel-Air, Inc.*, 680 P.2d 1109 (Alaska 1984), revised subsection (a)(1) provides that the seller also warrants that the title is uncontested. This protects the buyer against colorable “clouds” on an otherwise good title that affect the value of the goods. See, e.g., *Frank Arnold KRS, Inc. v. L.S. Meier Auction Co., Inc.*, 806 F.2d 462 (3d Cir. 1986) (two law suits contest title); *Jeanneret v. Vichey*, 693 F.2d 259 (2d Cir. 1982) (export restrictions in country from which painting was taken affect value); *Colton v. Decker*, 540 N.W.2d 172 (S.D. 1995) (conflicting vehicle identification numbers). As one court put it, there “need not be an actual encumbrance of the purchaser's title or actual disturbance of possession to permit a purchaser to recover for a breach of warranty of title when he demonstrates the existence of a cloud on his title, regardless of whether it eventually develops that a third party's title is superior. The policy is that a purchaser “should not be required to engage in a contest over the validity of his ownership. *Maroone Chevrolet, Inc. v. Nordstrom*, 587 So.2d 514, 518 (Fla.App. 1991) (conflicting vehicle identification numbers).

3. The statute of limitations for breach of warranty under subsection (a) runs from when the cause of action accrues under Section 2-725(2). Cf. *Foxley v. Sotheby's, Inc.*, 893 F. Supp. 1224 (S.D.N.Y. 1995) (suit against auctioneer claiming fraud in sale of forged art work). Under the Uniform Sales Act the statute ran from the time of delivery or when quiet possession was disturbed. See *Menzel v. List*, 246 N.E.2d 742 (N.Y. 1969). The question is whether in warranty of title disputes the statute should run from when the breach was or should have been discovered. Arguably, the latter time, capped by an appropriate tolling limitation, is proper. See *Balog v. Center Art Gallery-Hawaii, Inc.*, 745 F. Supp. 1556 (D.Haw. 1990) (warranty that art work “genuine” explicitly extended to future performance). At the March, 1996 meeting, the Drafting Committee agreed upon a “discovery statute of limitations with a four year tolling period. That decision will be implemented in Section 2-714.

4. The Drafting Committee deleted the phrase “in writing” from an earlier draft of subsection (b). The language of disclaimer need not be in a record. If the

disclaimer is in a record, however, the language must be conspicuous and can follow the suggested wording to secure a “safe harbor. See Section 2-316(c).

5. In March, 1995 meeting, the Drafting Committee concluded that (1) the disclaimer provisions in subsections (b) and (c) should be retained in Section 2-312 rather than moved to Section 2-316, and (2) no special protection for consumer buyers was needed in light of the new provision governing standard form records. Section 2-206.

6. Warranty issues involving infringement, subsection (e), the licensing of technology and transfers of other intellectual property remain to be decided. A probable model for revision is Article 42 of CISG.

7. Subsection (e) is new: Lack of privity is no defense between the seller and a remote buyer. A remote buyer's remedies against the seller, however, are limited by the contract between that seller and its immediate buyer and Article 2. In short, the remote buyer's rights are derivative. See Sections 2-313(a) (definitions) and 2-318(a). The cases are divided on whether lack of privity is a defense in warranty of title suits. See Note, 45 Bus. Lawyer 2289 at 2300 (1995); *Mitchell v. Webb*, 591 S.W.2d 547 (Tex.Civ.App. 1979) (lack of privity no defense).

SECTION 2-313. EXPRESS WARRANTIES.

(a) In Sections 2-313 through 2-318:

(1) “Damage means all loss resulting from a breach of warranty other than injury to a person or to property other than the goods sold or leased.

(2) “Goods includes a component incorporated in substantially the same condition into other goods;

(3) “Immediate buyer means a buyer in privity of contract with the seller;

(4) “Remote buyer or “Remote lessee means a buyer or lessee from a seller in the distributive chain other than the seller against whom a warranty claim is asserted;

(b) Any affirmation of fact or promise made by the seller to the immediate buyer that relates to the goods and becomes part of the agreement or any description of the goods or sample or model that becomes part of the agreement creates an express warranty that the goods will conform to the affirmation of fact, promise, or

description or that the whole of the goods will conform to the sample or model. To create an express warranty, it is not necessary that the seller use formal words, such as “warrant” or “guarantee,” or have a specific intention to make a warranty.

(c) Any affirmation of fact, promise, description, sample or model made or provided under subsection (b) becomes part of the agreement unless the seller establishes that a reasonable person in the position of the immediate buyer would either believe otherwise or believe that any affirmation, promise, or statement made was merely of the value of the goods or purported to be merely the seller's opinion or commendation of the goods.

(d) If the seller makes an affirmation of fact or promise relating to or a description of goods to a remote buyer or lessee through an authorized dealer or other intermediary of the seller or through any medium of communication to the public, including advertising, the following rules apply:

(1) An obligation is created if the remote buyer or lessee establishes that it knew of and was reasonable in believing that the goods purchased from another seller or lessor in the distributive chain would conform to the affirmation of fact, promise or description made by the seller;

(2) The obligation may be enforced by the remote buyer or lessee as an express warranty directly against the seller under this [article], subject to subsection (d) of Section 2-318.

SOURCE: Sales, Section 2-313 (May, 1995)

Notes

1. The May, 1994 Draft of Section 2-313 was revised after the March, 1995 meeting of the Drafting Committee to clarify and narrow its scope. The January, 1996 Draft implemented important changes made at the October 15, 1995 meeting of the Drafting Committee and was influenced by Alternative 1 proposed by the ABA Task Force in their Memo of December 4, 1995. The July, 1996 Draft makes further clarifications in light of the discussion at the January and March, 1996 meetings of the Drafting Committee.

Several questions remain:

First, is it clear enough that an express warranty with regard to new goods does not apply when those new goods become used? Is additional drafting needed to deal with the problem of used goods?

Second, Section 2-313 distinguishes express warranties made where there is privity of contract, subsections (b) and (c), and express warranties made to remote buyers or lessees. A important difference is who has what burden of proof. Should sales made after “direct response” and dealer advertising be treated as a privity or a non-privity case? In a “direct response” sale the buyer responds to public advertising by making a direct purchase from the advertising seller by mail, or by calling an 800 number or by accessing an internet site. If treated as a privity case, the buyer gets the benefit of a presumption that everything the seller says in advertising is an express warranty that becomes part of the agreement.

Third, the warranty identified in subsection (d)(1) – the so-called “pass through” warranty – needs further work. Arguably, this warranty would benefit from a separate definition and a subsection that states (1) the warranty creates a direct obligation to the remote buyer or lessee and (2) the warranty shall be treated as if it were to an immediate buyer for all purposes of Article 2.

2. Subsection (a) provides special definitions that apply in Sections 2-313 through 2-318.

3. Subsection (b) states the general principles applicable to an “immediate buyer who claims a breach of express warranty by the seller. They cover any case where there is privity of contract between the seller and buyer. Subsection (b) follows Section 2-313(1) of the 1990 Official Text except that the phrase “becomes part of the agreement” is substituted for “becomes part of the basis of the bargain. The change is intended to clarify that an express warranty is treated like any other term of the agreement and that the buyer need not prove reliance to establish an express warranty.

The last sentence of subsection (b) is taken without change from the first clause in Section 2-313(2) of the 1990 Official Text.

4. Subsection (c) states when a claimed affirmation of fact, promise, description or sample becomes “part of the agreement. If the “immediate” buyer alleges and proves what the seller affirmed, promised or displayed to the buyer about the goods, the assumption is that they become part of the agreement unless the seller establishes otherwise under subsection (c)(1) or (2). This is consistent with the Comments to Section 2-313 of the 1990 Official Text and most of the interpretive case law.

The first exception to inclusion is where the seller establishes that a reasonable person in the position of the buyer would not believe that the affirmation of fact or promise became part of the agreement. Thus, if the buyer did not hear the affirmation or did not believe it in fact or relied upon its own or another's skill and judgment, the exception would be satisfied.

The second exception to inclusion is where the seller establishes that what was affirmed or said about the goods was puffing. Put differently, the seller establishes that what was said was opinion, commendation or a general valuation not an affirmation of fact or promise. The only change from Section 2-313(2) of the 1990 Official Text is to confirm that the seller must establish that what it said **was** puffing rather than requiring the immediate buyer to establish that it was not. Put differently, “puffing” is a defense which the seller can raise in a motion for summary judgment or establish before a jury.

There are a number of factors relevant to whether a buyer is reasonable in believing that an express warranty rather than “puffing” is involved. For example, the buyer might be unreasonable if the seller's representations taken in context (1) were verbal rather than written, (2) were general rather than specific, (3) related to the consequences of buying rather than the goods themselves, (4) were “hedged” in some way, (5) related to experimental rather than standard goods, (6) concerned some aspects of the goods but not a hidden or unexpected non-conformity, (7) were phrased in terms of opinion rather than fact, or (8) were not capable of objective measurement. See *Federal Signal Corp. v. Safety Factors, Inc.*, 886 P.2d 172 (Wash. 1994), where the court held that the trial court erred in not making findings of fact where the seller stated that a new product was “better than” an earlier, comparable model. See also, *Jordan v. Paccar, Inc.*, 37 F.3d 1181 (6th Cir. 1994) (representations about strength of fiberglass roof which shattered and caused personal injury when the truck rolled over were “puffing” as a matter of law).

5. Subsection (d) states when an express warranty may be made to a “remote buyer” and provides special rules for this non-privity situation. If an express warranty is made, see subsections (b) and (c), it creates an obligation which the remote buyer may enforce directly against the seller under Article 2, subject to Section 2-318(d). In essence, the seller's affirmations and promises create an obligation to the buyer that the goods purchased from another seller or lessor in the distributive chain will conform to the warranties made. Simply put, there is a “bargain of sorts” between the seller and the remote buyer which is created by and enforced under Article 2. It is treated like a contract claim rather than a tort or a claim for innocent, material misrepresentation. See Wayne Lewis, *Toward a Theory of Strict Claim Liability: Warranty Relief for Advertising Representations*, 47 Ohio St. L. J. 671 (1986) (tracing history).

6. Under subsection (d)(2), where an express warranty is made to the public by any medium of communication, including advertising, the remote buyer or lessee must establish both that an affirmation of fact or promise or description was made and communicated (that is was not “puffing”) and that it created an express warranty obligation. The remote buyer does not get the benefit of any presumption and is required to prove that its expectations were reasonable. This implements the decision of the Drafting Committee at the October, 1995 meeting.

7. The phrase “or lessee” in subsection (b) puts the lessee in the same position as a “remote buyer” when enforcing express warranties made by the seller.

SECTION 2-314. IMPLIED WARRANTY: MERCHANTABILITY; USAGE OF TRADE.

(a) Subject to Section 2-316, a warranty that goods are merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. The serving for value of food or drink to be consumed on the premises or elsewhere is a sale under this section.

(b) To be merchantable, goods, at a minimum, must:

- (1) pass without objection in the trade under the agreed description;
- (2) in the case of fungible goods, be of fair, average quality within the description;
- (3) be fit for the ordinary purposes for which goods of that description are used;
- (4) run, within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved;
- (5) be adequately contained, packaged, and labeled as the agreement or circumstances may require; and
- (6) conform to the promise or affirmations of fact, if any, made on the container or label.

(c) Subject to Section 2-316, other implied warranties may arise from course of dealing or usage of trade.

SOURCE: Sales, Section 2-314 (March, 1995)

Notes

1. Subsection (b)(7) in the May, 1995 Draft, dealing with the merchantability of goods to be consumer or applied to the human body, was deleted at the October, 1995 meeting of the Drafting Committee. The problems are too complex to catch in a single sentence and are best left for the courts to resolve under the more general standard of merchantability in Section 2-314(b) or the evolving law of products liability. See Restatement of the Law Torts: Products Liability § 2, comment (g) (Tent. Draft No. 2, March 13, 1995).

Under proposed Section 2-319, Article 2 does not apply to the extent that an allegedly unmerchantable product that “proximately caused injury to person or property” was defective under applicable tort law. Suppose, however, that the goods are not defective under tort law. Does that mean they must be merchantable

under Section 2-314? In most cases the answer will be yes. For example, goods that do not contain a manufacturing defect will, in all probability, be fit for the ordinary purposes for which goods of that description are used. The policy question is whether defect in tort and merchantability in warranty should be coterminous. If the answer is yes, then proposed Section 2-319 or a Comment to Section 2-314 should implement that decision.

2. Revised Section 2-314(a) does not displace or preempt any inconsistent state law, such as the so-called “blood shield” statutes enacted by many States, which immunize suppliers of blood and other body parts from implied warranty liability under Article 2 or strict liability in tort. See, e.g., *Doe v. Travenol Laboratories, Inc.*, 698 F. Supp. 780 (D. Minn. 1988).

3. Is there a better way to state the merchantability standard? For example, the revised British Sale of Goods Act now speaks of an implied warranty of “satisfactory quality” (“satisfactory” to whom?) rather than merchantability. Or, Article 35(2)(a) of CISG states that goods do not conform to the contract unless they are “fit for the purposes for which goods of the same description would ordinarily be used.” One person suggested a standard of fitness for “ordinary use and purposes.” Finally, it was suggested that Article 35(2)(d) of CISG, which provides that the goods must be “contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods,” should replace Section 2-314(2)(5). To date, the Drafting Committee has not pursued any of these alternatives.

SECTION 2-315. IMPLIED WARRANTY: FITNESS FOR PARTICULAR PURPOSE. Subject to Section 2-316, if a seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is an implied warranty that the goods are fit for that purpose.

SOURCE: Sales, Section 2-315 (March, 1995)

SECTION 2-316. EXCLUSION OR MODIFICATION OF WARRANTIES.

(a) Words or conduct relevant to the creation of or tending to exclude or modify an express warranty must be construed if reasonable as consistent with each other. Subject to Section 2-202 with regard to parol or extrinsic evidence, if such a

construction is unreasonable, words excluding or modifying an express warranty are inoperative to that extent.

(b) Except in a consumer contract, if language in an agreement is construed to exclude or modify an implied warranty, the following rules apply:

(1) Unless the circumstances indicate otherwise, all implied warranties are excluded or modified by expressions like “as is, or “with all faults or other language that under the circumstances calls the buyer's attention to the exclusion or modification of the warranties and states that the implied warranties have been excluded or modified.

(2) Subject to Section 2-206, language contained in a record that excludes or modifies implied warranties is sufficient to satisfy paragraph (1) in the following cases:

(i) An exclusion or modification of the implied warranty of merchantability is sufficient if the language is conspicuous and mentions merchantability. Conspicuous language that states “These goods may not be merchantable or language of similar import is sufficient;

(ii) An exclusion or modification of the implied warranty of fitness is sufficient if the language is conspicuous. Conspicuous language that states “There are no warranties that these goods will conform to the purposes for which they are purchased made known to the seller, or words of similar import is sufficient.

(3) If the buyer before entering into the contract has examined the goods, sample, or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to conditions that an examination in the circumstances would have revealed.

(4) An implied warranty may be excluded or modified by course of performance, course of dealing, or usage of trade.

(e) Terms in a consumer contract excluding or modifying the implied warranty of merchantability or the implied warranty of fitness for particular purpose must be contained in a record and be conspicuous. **[The terms are inoperative unless the seller establishes by clear and affirmative evidence that the buyer expressly agreed to them.]**

(f) Remedies for breach of warranty may be limited in accordance with this [article] with respect to liquidation or limitation of damages and contractual modification of remedy.

SOURCE: Sales, Section 2-316 (March, 1995)

Notes

1. Subsection (a) preserves the policy that when an express warranty and a term excluding or modifying that warranty are inconsistent, the disclaimer is inoperative, subject to Section 2-202 (the “parol evidence rule”). The enforceability of merger clauses in standard form contracts is governed by Section 2-206(a).

2. Subsection (b) now governs the exclusion or modification of implied warranties in commercial contracts. After the October, 1995 meeting of the Drafting Committee, subsections (b), (c), and (d) of the October, 1995 Draft were integrated into a single, new subsection (b). At the January, 1996 meeting of the Drafting Committee, the decision was made to delete all “regulatory” and “mandatory” language in subsection (b) and to provide a “safe harbor” for language contained in a record. Thus, subsection (b)(1) now states a general standard for exclusion or modification of implied warranties whether or not the language is contained in a record. Subject to Section 2-206, if the language is in a record, subsection (b)(2) states what language, if used, will be effective to modify or exclude. The seller who follows this language will have a “safe harbor” unless the exclusion or modification is unconscionable on other grounds. See Sections 2-206(a) and 2-105(a). If not within the “safe harbor,” the seller may still prevail under the general standard in subsection (b)(1). For example, if the language in the record was not conspicuous but the term was negotiated, it would be outside the “safe harbor” in subsection (b)(2) but effective under subsection (b)(1).

The Drafting Committee has not decided whether a “safe harbor” for the “as is” disclaimer should be drafted.

3. Subsection (e), which is subject to new Section 2-319, states the exclusive requirements in a consumer contract for the seller to disclaim or limit any

implied warranty. This applies to new, used, or distress goods or seconds, and preempts subsection (b). Rather than providing that such disclaimers are inoperative, subsection (e) puts the burden on the seller to establish by clear and affirmative evidence that the consumer expressly agreed to the term in the record. “Expressly agreed” means, at a minimum, that the buyer was aware of the disclaimer term before assenting to the record. Compare Section 2-206(b).

At the 1995 Annual Meeting of NCCUSL, the House voted to delete the bracketed language in subsection (e). It has been restored with some modifications for further discussion.

SECTION 2-317. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative. However, if that construction is unreasonable, the intent of the parties determines which warranty prevails. In ascertaining that intent, the following rules apply:

(1) Exact or technical specifications prevail over an inconsistent sample or model or general language of description.

(2) A sample from an existing bulk prevails over inconsistent general language of description.

(3) Except in a consumer contract under Section 2-316(e), an express warranty prevails over inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

SOURCE: Sales, Section 2-317 (March, 1995)

Notes

1. One change was made in Section 2-317. An implied warranty of merchantability in a consumer contract that is inconsistent with an express warranty is not displaced under Section 2-317(3). Rather, the requirements of Section 2-316(b) must be satisfied.

SECTION 2-318. EXTENSION OF EXPRESS OR IMPLIED WARRANTIES.

(a) A seller's express or implied warranty made to an immediate buyer extends to any remote buyer or lessee of or person who may reasonably be expected to purchase, use, or be affected by the goods and who is damaged by breach of the warranty. The rights and remedies against the seller for breach of a warranty extended under this subsection are determined by the enforceable terms of the contract between the seller and the immediate buyer and this [article]. The seller's obligation to a remote purchaser of or person affected by the goods, however, shall not exceed that owed to the immediate buyer.

(b) If a seller makes an express warranty to a remote buyer or lessee under Section 2-313(d) or for reasons other than the assignment of a right or claim of warranty under Section 2-403 the remote buyer or lessee may enforce a claim for breach of warranty directly against the seller, the following rules apply:

(1) The remote buyer or lessee may maintain an action against the seller without regard to the terms of the contract between the seller and the immediate buyer; and

(2) The remote buyer's or lessee's rights and remedies against the seller are determined under this [article], subject to subsection (c).

(c) A remote buyer or lessee under subsection (b) has the rights and remedies available against the seller provided by this [article], except as follows:

(1) The time for giving a required notice begins to run when the remote buyer or lessee receives the goods.

(2) A remote buyer or lessee other than a consumer buyer or lessee may not recover consequential damages unless the conditions of paragraph (3) are satisfied.

(3) Within a reasonable time after receipt of a timely notice of rejection or revocation of acceptance from the remote buyer or lessee of the sale or lease to

it, and all intervening sales, the seller may tender a refund of the price or allocable rent paid by the remote buyer or lessee or tender goods that conform to the warranty. If a complying tender is made, the seller's liability is limited to incidental damages under Section 2-705, whether or not the tender is accepted by the remote buyer or lessee. If the tender fails to comply with this subsection, the remote buyer or lessee may recover damages for breach of warranty, including incidental and consequential damages under Sections 2-705 and 2-706.

(4) A [cause of action/claim] for relief for breach of warranty accrues no earlier than the time when the remote buyer or lessee receives the goods.

(d) A seller may not exclude or limit the operation of this section.

SOURCE: Sales, Section 2-318 (March, 1995)

Notes

1. Section 2-318 has been the subject of considerable discussion, both within and without the Drafting Committee, and is still a “work in progress. After the 1994 NCCUSL Annual Meeting, the May, 1994 Draft was further revised for clarity and was discussed at the March, 1995 meeting of the Drafting Committee. In response to suggestions made at that meeting, the section was further revised for clarity and consistency and subsection (c) was limited to sellers of unmerchantable new goods. This latest revisions follow extended discussion at the October, 1995 and January, 1996 meetings of the Drafting Committee.

2. **Overview.** Section 2-318 deals with warranty claims by a buyer or lessee [called a “remote buyer to distinguish a buyer with privity, called an “immediate buyer] against “the seller with whom there is no privity of contract. See Section 2-313(a) for the definitions. The remote buyer may be a commercial or a consumer buyer who claims economic loss, including damage to goods sold, but not injury to person or property other than the goods sold. See Section 2-319. The section also deals with “remote lessees.

3. A remote buyer or lessee may sue the seller for breach of warranty in two types of cases.

Subsection (a). In the first, the seller's warranty made to an immediate buyer is extended to a foreseeable purchaser or user [a “beneficiary] who is damaged by the breach. In these cases, the remote person's rights against the seller are limited by the terms of the contract between the seller and the immediate buyer and the terms of this Act. It is, in short, a derivative warranty and the beneficiary stands in the shoes of the immediate buyer.

Although protected persons are called beneficiaries under subsection (b), the warranty extension is based more upon policy than intention of the parties. The seller **should** be responsible to foreseeable buyers and users for the quality of the goods warranted to the immediate buyer. But since the warranty is derivative, the beneficiary is bound by the terms and conditions of the contract between the seller and immediate buyer. Thus, disclaimers and agreed limited remedies in that contract bind the beneficiaries as well. See subsection (a), last sentence. Put differently, policy may dictate an extension under subsection (a), but it does not require seller liability beyond that for which it bargained with the immediate buyer. Moreover, the seller's obligation to a remote purchaser or user should not exceed that owed to the immediate buyer. To illustrate, suppose that consequential damages were not excluded in the contract between the seller and the immediate buyer and that the immediate buyer suffered no consequential loss. Even if the remote purchaser suffered provable consequential damages they are not recoverable against the seller. This limitation implements a decision of the Drafting Committee at the January, 1996 meeting.

Subsection (a) should be distinguished from cases where an immediate buyer to whom a warranty has been made by the seller assigns the warranty or rights under it to a remote purchaser under Section 2-210. In these cases, the remote purchaser's rights against the seller are based upon the assignment rather than subsection (a) and are subject to the contract and relevant defenses between the seller and the immediate buyer. They should be treated under Section 2-210 rather than Section 2-318(a). A leading case is *Collins Co. v. Carbonline Co.*, 864 F.2d 560 (7th Cir. 1989).

Subsection (b). In the second, the seller is liable to a remote buyer or lessee for breach of express warranty made to the public and extended under Section 2-313(d)(ii). This is not a derivative warranty under Section 2-318(b) or by assignment. Rather, the remote buyer or lessee has a direct action against the seller, the content of which is defined by Article 2 as modified by subsection (d). Moreover, this is not a "pass through" warranty extended to a remote buyer under Section 2-313(d)(i). Although lack of privity is not a defense in the "pass through" warranty, the relationship between seller and remote buyer is treated as if there were privity of contract.

Similarly, if a court decides or applicable law dictates for any other reason that a seller has a direct warranty obligation to a remote buyer or lessee for breach of warranty, the case is also governed by subsection (c). Thus, a court might conclude that a remote commercial or consumer buyer has a direct claim against the seller for damage resulting from breach of an implied warranty of merchantability, see, *Hininger v. Case Corp.*, 23 F.3d 124 (5th Cir. 1994) (reviewing Texas law), or that there were sufficient direct dealings between the seller and the remote buyer before and after the contract to establish privity, see *U.S. Roofing, Inc. v. Credit Alliance Corp.*, 279 Cal. Rptr. 533 (Cal.App. 1991). Note that subsection (c) of the July, 1996 Draft has been revised to remove all references to a consumer buyer of new goods and to leave the matter in the hands of the courts.

To repeat, the derivative theory of subsection (a) does not apply to the cases described in subsection (b). Thus, protected remote buyers and lessees under subsection (b) may sue the seller free of the lack of privity defense and the terms in the contract between the seller and the immediate buyer. Furthermore, there is no

intention to preclude the courts from applying the principle of subsection (b) to unmerchantable goods which are sold by M to R and resold to a commercial buyer. See Section 2A-209.

4. Remote buyers and lessees protected under subsection (b) who sue the seller for a breach of a warranty are not subject to the “no privity” defense or the limitations of subsection (a). They may sue the seller as if there were privity of contract under Article 2, subject to subsection (c). Subsection (c) provides adjustments that reflect the reality that the remote buyer has not contracted with the seller.

A key issue in subsection (c) is the treatment of consequential damages. Should the seller be liable to a remote buyer or lessee with whom it has not contracted for consequential damages proved under Section 2-706? For remote consumer buyers the answer is yes. For remote commercial buyers and lessees, the answer is no unless the seller has failed to tender a refund or conforming goods within a reasonable time. If the complying tender is made and the buyer does not accept it, consequential damages are foreclosed. The seller, of course, may still exclude liability for consequential damages to a remote buyer by an agreement with that buyer, i.e., through a dealer.

5. Subsection (d) provides that a seller may not exclude or limit the “operation” of this section. The seller may, however, limit or condition the warranty extended to a remote purchaser or the remedies for breach in the relevant record or communication. For example, a seller may both make and condition an express warranty to a remote buyer through a dealer or intermediary. The remote buyer's rights depend upon the scope of this warranty. Once the scope of the warranty is established, however, the seller may not limit or foreclose the remote purchaser's right to enforce it. See *Recold, S.A. de C.V. v. Monfort of Colorado, Inc.*, 893 F.2d 195 (8th Cir. 1990). The Style Committee recommends that subsection (d) be deleted: It is “superfluous in light of Section 2-109.

6. The definition of “the seller” in Section 2-313(a) is broad enough to include a seller whose sale is governed by the Convention on the International Sale of Goods. Under CISG, the seller's liability for non-conforming goods extends only to the immediate buyer. Lack of privity is a defense. But if the CISG seller's immediate buyer resells to a buyer in a State governed by the UCC, the CISG seller could be liable to the non-CISG remote buyer under Sections 2-313 and 2-318. Complex federal preemption issues aside, a foreign seller is not insulated from warranty extensions to remote non-CISG buyers under the UCC.

SECTION 2-319. INJURY TO PERSON OR PROPERTY RESULTING FROM BREACH OF WARRANTY.

(a) In this section:

(1) “Property” means any real or personal property, other than the goods purchased;

(2) If personal injuries are involved, “person” means an individual not an organization.

[(b) This [article] applies to a claim for injury to person or property resulting from any breach of warranty to the extent that the goods are not defective under other applicable law.]

(c) Claims under subsection (b) to which this [article] applies are also subject to the following rules:

(1) A claim is not barred for failing to give notice as required by Section 2-608(c)(1).

(2) Any agreement, however expressed, that excludes or limits consequential damages for injury to the person is unenforceable.

(3) A [cause of action/claim for relief] accrues when the purchaser discovers or should have discovered the breach. An action must be commenced within four years after the cause of action has accrued.

(4) A seller's warranty extends to an “immediate” buyer and any “remote” buyer, user or person affected protected under Section 2-318.

Notes

1. Section 2-319, which is new, attempts to harmonize the tension between warranty theory and tort law where goods cause injury to person or property. A primary source of tension is the overlap between the concept of merchantability in warranty law and the concept of defect in tort law. A secondary source of tension is the different treatment afforded by Article 2 and tort law to such issues as privity of contract, notice, disclaimers of warranty and exclusions of consequential damages and the statute of limitations. The long-standing confusion and disagreement over these issues suggests that a legislative accommodation is needed.

2. One possible solution is to delete Section 2-706(a)(2), which defines consequential damages to include “injury to person or property proximately from breach of warranty.” Article 2 damages would be limited to economic losses, including damage to the goods sold, caused by a breach of warranty. Similarly, protected persons could be limited to “buyers” of rather than “users and persons affected” by the goods.

The primary objection to this solution is that products liability law is far from uniform among the States. In fact, in some States where products liability in

tort is limited Article 2 is the main vehicle for imposing liability. Thus, the deletion of Section 2-706(a)(2) may exacerbate rather than reduce the tension.

3. Proposed Section 2-319 takes a less drastic route to harmonization.

First, “property” is defined to exclude damage to the goods purchased. This is consistent with the ALI’s proposed Restatement of Products Liability and most case law.

Second, subsection (b) states that if a plaintiff invokes warranty theory in a claim for injury to person or property, Article 2 applies to the extent that the goods are not defective under other applicable tort law. Thus, if the goods are defective because of a manufacturing or a design defect or a failure to warn, applicable tort law rather than Article 2 applies to the claim even though there is also a breach of warranty. For example, suppose that the seller sells food with glass in it. Personal injuries result. Since the goods are both defective and unmerchantable, Article 2 does not apply.

Third, to the extent that the goods are not defective under products liability law, subsection (c), relying on subsection (b), states that Article 2 applies, subject to stated special rules. There are complexities here that must be identified.

Suppose, first, that the goods contained a manufacturing defect (and were unmerchantable) and also failed to conform to an express design warranty. Injury to person resulted from the defect but economic loss rather than personal injury resulted from breach of the express warranty. Here tort law governs the personal injury claim and Article 2 governs the economic loss claim. On the other hand, if there was no breach of express warranty and economic loss as well as personal injury resulted from the defect, tort law governs all claims.

Suppose, second, that the goods were not defective (and were merchantable) but they failed to conform to an express warranty or an implied warranty of fitness for particular purpose. Injury to person and property and economic loss resulted from the non-conforming goods. Here Article 2 governs the entire claim.

Suppose, third, that the goods were not defective and there was no express warranty or implied warranty of fitness. The plaintiff, who claims injury to person and property, argues that the goods were, nevertheless, unmerchantable. There is disagreement over whether goods that are not defective can also be unmerchantable. The position of the American Law Institute is that the answer is no and that this answer should be stated in Article 2 in either the text or a Comment. [For a possible Comment, see Notes to Section 2-314.] Clearly, this will be the result in most cases. There is, however, some case law to the contrary. See *Denny v. Ford Motor Company*, ___ N.E.2d ___, 1995 WL 722844, 28 UCC Rep.Serv.2d 15 (N.Y. 1995) (vehicle properly designed for off the road use was unmerchantable when used on the road). Moreover, the relevant factors defining merchantability in Section 2-314(b) are broader than those defining defect in tort. Accordingly, subsection (c) gives the plaintiff an opportunity to plead and prove that non-defective goods are still unmerchantable under Section 2-314(b) as well as that the seller has made and breached an implied warranty of fitness or an express warranty.

This issue has not been finally resolved by the Drafting Committee and has been bracketed for discussion at the Annual Meeting.

Fourth, Article 2 and subsection (c) provide rules where non-defective goods which fail to conform to a warranty cause injury to person or property. They reject the notion that the injured buyer should jump through all of the contract hoops to which a buyer seeking economic loss is subjected.

1. The notice condition in Section 2-608(c)(1) does not apply to injury claims. It is sufficient that an action be commenced within the relevant statute of limitations.

2. Any agreement excluding liability for consequential injury to person or property is unenforceable. See Section 2-709(c). A disclaimer of implied warranties that complies with Section 2-316, however, is enforceable.

3. A “discovery” statute with a four year limitation period applies. There was some concern among the Drafting Committee about this, however, so that subsection (c)(3) is still open for discussion.

4. Under the July, 1996 Draft, the scope of the privity requirement for injury and economic loss claims is determined by Section 2-318. The Drafting Committee must still decide whether the injury claim should be flagged for special treatment. For example, Alternatives A and B under Section 2-318 of the 1990 Official Text might be provided.

In sum, several important policy questions are tentatively resolved in Section 2-319. For example, should Article 2, which protects expectations created by contract warranties, permit warranty theory to control injury claims to the extent that tort theory is not applicable? If so, should injury claims be treated differently than economic loss claims in allocating risk by agreement and enforcing warranty claims? Section 2-319 gives an affirmative answer to both questions.

SECTION 2-320. SALE BY AUCTION.

(a) In a sale by auction, if goods are put up in lots, each lot is the subject of a separate sale.

(b) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. In the case of a previous bid, the auctioneer may either reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(c) A sale by auction is with reserve unless the goods in explicit terms are put up without reserve. In an auction with reserve, the auctioneer may withdraw the

goods at any time until completion of the sale is announced. In an auction without reserve, after the auctioneer calls for bids on an article or lot, the article or lot may not be withdrawn pending a bid within a reasonable time. In either case, a bidder may retract a bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(d) If an auctioneer knowingly receives a bid on a seller's behalf or the seller makes or procures a bid, and notice has not been given that liberty for such bidding is reserved, the buyer at the buyer's option may avoid the sale or take the goods at the price of the last bid made in good faith before the completion of the sale. This subsection does not apply to a bid at a forced sale.

SOURCE: Sales, Section 2-322 (December, 1994)

Notes

No revisions are proposed in former Section 2-318. There are relatively few cases and they reveal no major problems of interpretation. For a focused analysis, see Jorge Contreras, *The Art Auctioneer: Duties and Assumptions*, 13 *Hastings Comm./Ent. L. J.* 717 (1991). See also, Patty Gerstenblith, *Picture Imperfect: Attempted Regulation of the Art Market*, 29 *Wm. & Mary L. Rev.* 501 (1988).

PART 4
TRANSFERS, IDENTIFICATION, CREDITORS,
AND GOOD FAITH PURCHASERS

**SECTION 2-401. PASSING OF TITLE; RESERVATION FOR
SECURITY.**

(a) Except as otherwise expressly provided in this [article], this [article] applies whether or not the seller, buyer, or a third party has title to or possession of the goods and notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent.

(b) In cases not covered by other provisions of this [article], if the location of title is material, the following rules apply:

(1) Title to goods does not pass under a contract for sale before their identification to the contract. Unless otherwise expressly agreed, a buyer acquires by their identification a special property interest as limited by this [article].

(2) Any retention or reservation by the seller of title in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest.

(3) Subject to this subsection and [Article] 9, title to goods passes from the seller to the buyer in any manner and on any conditions expressly agreed to by the parties.

(4) Title passes to the buyer at the time and place at which the seller completes performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even if a document of title is to be delivered at a different time or place.

(5) Despite any reservation of a security interest by the bill of lading:

(i) if the contract requires or authorizes the seller to send the goods to the buyer but does not require the seller to deliver them at destination, title passes to the buyer at the time and place of shipment; and

(ii) if the contract requires delivery at destination, title passes on tender there.

(c) If delivery is to be made without moving the goods and the seller is to deliver a document of title, title passes when and where the seller delivers the document.

(d) If delivery is to be made without moving the goods and the goods are already identified at the time of contracting and no document is to be delivered, title passes at the time and place of contracting.

(e) Title to goods reverts in the seller upon the buyer's rejection or refusal to receive them, whether or not justified, or upon the buyer's justified revocation of acceptance. Revesting occurs by operation of law and is not a sale.

SOURCE: Sales, Section 2-401 (December, 1994)

Notes

1. No changes of substance have been made in Section 2-401 of the 1990 Official Text.

2. Although a sale occurs when title passes from seller to buyer for a price, Section 2-102(a)(33), the location of title is largely irrelevant under Article 2. The same is true under CISG. See Article 4(b) which states that CISG is not "concerned with ... the effect which the contract may have on the property in the goods sold. Section 2-401 may be relevant to disputes over the location of title arising outside of Article 2. No effort has been made to identify those disputes or determine whether the rules of Section 2-401 are applicable to them.

SECTION 2-402. INSURABLE INTEREST IN GOODS; MANNER OF IDENTIFICATION OF GOODS.

(a) Identification of goods as goods to which a contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs when:

(1) the contract is made, if the contract is for the sale of existing and described goods;

(2) goods are shipped, marked, or otherwise designated by the seller as goods to which the contract refers, if the contract is for the sale of future goods other than those described in paragraph (3) or (4);

(3) crops are planted or otherwise become growing crops, if the contract is for the sale of crops to be harvested within 12 months or the next normal harvest season after contracting, whichever is longer; or

(4) young are conceived, if the contract is for the sale of the unborn young of animals to be born within 12 months after contracting.

(b) A buyer obtains a special property interest and an insurable interest in existing goods identified to the contract even if the goods are nonconforming and the buyer has an option to return or reject them.

(c) A seller has an insurable interest in identified goods as long as title to or a security interest in the goods is retained. If the identification is by the seller alone, the seller may substitute other goods for those identified until default or insolvency or notification to the buyer that the identification is final.

(d) This section does not impair an insurable interest recognized as such under any other law.

SOURCE: Sales, Section 2-501 (December, 1994)

Notes

1. Subsection (a) is revised for a clearer focus on how and when goods are identified to the contract. See Section 2A-217, from which the form was taken. However, no change was made in the rules of “how” and “when” identification occurs in the absence of “explicit agreement.”

2. What the buyer gets upon identification is stated in subsection (b). No change is made in the original Section 2-501: The buyer gets both an insurable interest and a special property interest.

3. The extent to which a seller retains an insurable interest in identified goods is stated in Section 2-402(c). No change is made. In light of Section 2-402(d), the insurable interest of both seller and buyer complements or is in addition to insurable interests recognized by other sources of law.

4. **Advantages of Identification.** The advantages to the buyer of identification and obtaining a “special property interest” are not stated in Section 2-402. These advantages include: (1) The acquisition of “goods oriented” remedies against the seller under Sections 2-724 and 2-707; (2) Protection against the seller's creditors under Section 2-405; (3) Earlier status, in some States, as a buyer in ordinary course of business under Section 1-201(9); (4) A right to inspect the goods under Section 2-513(a); and (5) Standing to sue third parties who cause injury to identified goods, Section 2-713.

Similarly, the advantages to the seller of identification are not stated in Section 2-402. These advantages include: (1) Shipment under reservation, Section 2-508(a); (2) Resale under Section 2-719(a); (3) Possible excuse where goods identified at the time of contracting are damaged or destroyed, Section 2-615; (4) Possible action for the price upon breach by the buyer, even though the goods have not been accepted, Section 2-722(a)(2); and (6) Standing to sue third parties who cause injury to identified goods, Section 2-713. In addition, the seller, upon breach, may make a commercially reasonable decision to identify goods to the contract and pursue appropriate remedies. See Section 2-717.

When the advantages to both parties of identification are catalogued, it is difficult, as Comment 2 states, to conclude that identification has a “limited effect under Article 2.

5. **CISGA.** There is no comparable provision in CISGA. But see Article 32(1), dealing with notice requirements when goods shipped by the seller are not “clearly identified to the contract.

SECTION 2-403. ASSIGNMENT OF RIGHTS.

(a) All rights of a seller or buyer may be assigned unless the assignment would materially change the duty of the other party, increase the burden or risk imposed on it by the contract, or impair its likelihood of obtaining return performance. A right to damages for breach of the whole contract, or a right arising out of the assignor's due performance of its entire obligation, may be assigned despite agreement otherwise.

(b) Unless the circumstances indicate the contrary, a prohibition of assignment or transfer of “the contract” must be construed as precluding only the delegation to the assignee or transferee of the assignor's duty to perform.

(c) An assignment or transfer of “the contract” or “all my rights under the contract,” or an assignment or transfer in similar general terms, is an assignment of rights. Unless the language or the circumstances, as in an assignment for security, indicate the contrary, the assignment or transfer is a delegation of performance of the duties of the assignor.

(d) Acceptance of a delegation of duties by an assignee constitutes a promise by the assignee to perform those duties. The promise is enforceable by the assignor or the other party to the original contract. The other party may treat any assignment or transfer that delegates performance as creating reasonable grounds for insecurity and, without prejudice to the party's rights against the assignor, may demand assurances from the assignee.

SOURCE: Sales, Section 2-210 (December, 1994)

Notes

1. There are no changes of substance in Section 2-403, which is derived in part from Section 2-210 of the 1990 Official Text. The consequences of a delegation of performance are treated in Section 2-211. Compare Section 2A-303. In the absence of a “hub-spoke” configuration, Sections 2-211 and 2-403 should probably be reintegrated.

2. If a contract contains warranties and the buyer either transfers the contract or assigns the rights to a third party, the third party can usually enforce the warranties against the seller. See Section 2-318.

SECTION 2-404. POWER TO TRANSFER; GOOD-FAITH PURCHASE OF GOODS.

(a) Except as otherwise provided in this section, a purchaser of goods acquires rights and title identical to those the transferor had or had power to

transfer. A purchaser of a limited interest in goods acquires rights and title only to the extent of the interest purchased.

(b) A person with voidable rights or title acquired in a transaction of purchase from a seller who has relinquished possession or control has power to transfer a good title to a good faith purchaser for value. A transaction of purchase includes a transaction in which:

- (1) the transferor was deceived as to the identity of the purchaser;
- (2) the delivery was in exchange for a check later dishonored;
- (3) it was agreed that the transaction was to be a “cash sale” ; or
- (4) the delivery was procured through fraud punishable under criminal law.

(c) An entrusting of possession of goods to a merchant who deals in goods of that kind gives the merchant power to transfer all rights and title of the entruster and to transfer the goods free of a security interest perfected by the entruster under [Article] 9 to a buyer in the ordinary course of business.

(d) In this section, “entrusting” includes any delivery and any acquiescence in retention of possession, regardless of any condition expressed between the parties to the delivery or acquiescence or whether the procurement of the entrusting or the possessor's disposition of the goods was punishable under criminal law.

SOURCE: Sales, Section 2-403 (December, 1994)

Notes

1. Section 2-404, formerly Section 2-403 of the 1990 Official Text, has been revised to clarify the cases where a purchaser of goods gets better rights or title than the transferor had power to transfer. Section 2-404(a) states the *nemo dat* principle in a separate subsection. Without more, a buyer gets no more rights and title to goods than that of its seller. Section 2-404(b) states the good faith purchaser exception to the *nemo dat* principle. The BFP's seller must obtain voidable rights or title in a transaction of purchase from the purported true owner before there is power to transfer good title. The purported true owner must give up possession and control of the goods in that transaction, but not necessarily to the BFP's seller. The power to pass good title includes but is not limited to the four situations stated.

Remaining questions about the scope of “transaction of purchase, when title or rights are voidable, and who is a good faith purchaser for value are left to the courts.

2. Section 2-404(c) clearly states that a secured party who entrusts goods to a merchant who did not create the security interest, see Section 9-307(1), will lose the security interest to a buyer in the ordinary course of business. See Section 2-402(c)(1).

3. An assumption is that subsection (c) preempts state certificate of title legislation and that the “shelter” principle is in operation. Thus, if goods are entrusted to a merchant for repair and the merchant sells them to a non-merchant, the non-merchant has power to transfer good title to a good faith purchaser for value.

SECTION 2-405. RIGHTS OF SELLER'S CREDITORS AGAINST GOODS SOLD.

(a) Except as otherwise provided in subsections (b) and (c), rights of creditors of the seller with respect to goods identified to a contract for sale and retained by the seller are subject to the buyer's right to possession of the goods under Sections 2-724 and 2-707.

(b) A creditor of a seller in possession of goods subject to a contract for sale may treat the contract as void or voidable if, as against the creditor, retention of possession by the seller is fraudulent or void or voidable under any statute or rule of law. However, it is not fraudulent for a seller, for a commercially reasonable time after the contract becomes enforceable, to retain possession in good faith and current course of trade.

(c) Except as otherwise provided Section 2-404(c), this [article] does not impair rights of a creditor of the seller:

(1) under [Article] 9; or

(2) if an identification to the contract or a delivery is made not in current course of trade but in satisfaction of or as security for a preexisting claim for money, security, or the like, and under circumstances that under any statute or rule

of law apart from this [article] would constitute the transaction a fraudulent transfer or voidable preference.

SOURCE: Sales, Section 2-402 (December, 1994)

Notes

1. Under revised subsection (a), the rights of “creditors of the seller” not just “unsecured creditors” are now subject to the buyer's right to possession of the goods under Sections 2-724 (formerly Section 2-502) and 2-707 (formerly Section 2-716). This change expands the buyer's goods oriented remedies against creditors of the seller, including secured and lien creditors. The right to possession alone, however, does not determine priorities.

2. The rights of an Article 9 secured creditor of the seller against a buyer are preserved under subsection (c)(1), unless stated otherwise in Sections 2-724 and 2-707 or Section 2-404(c) is involved. Revised subsection (a) simply protects the buyer's right to recover the goods against the creditor. It does not provide that a security interest is “cut off” or that the buyer has priority. If, however, the buyer is a buyer in the ordinary course of business, the security interest might be cut off under Section 9-307(1) or Section 2-404(c).

A few illustrations reveal the broad operation of this provision. In all, assume that the buyer is entitled to the possession of goods retained by the seller under either Section 2-724 or 2-707.

#1. C becomes an unsecured creditor of S either before or after the contract for sale. C loses to B unless the retention is fraudulent under Section 2-405(b) or (c)(2) apply.

#2. LC obtains a judicial lien on the goods either before or after the contract for sale. If before, B may take priority over the judicial lien under non-Code law. If after and title has passed, B may be protected from the judicial lien under non-Code law. In either case, LC's rights are subject to B's right to **recover** the goods, unless subsection (b) or subsection (c)(2) applies. The potential priority issue is not clearly resolved.

#3. SP creates a security interest in the goods either before or after the contract for sale. If before, a buyer in the ordinary course of business may take free of that security interest under Section 9-307(1) or Section 2-404(c). If after, SP may take subject to buyer's rights in the collateral. In either case, buyer has a right to recover the goods against SP. Again, the potential priority issue is not resolved in Section 2-405.

Since December, 1995 representatives of the Article 2 and Article 9 Drafting Committees have met twice to discuss this and other overlap problems between sales and secured transactions. Although a general consensus has emerged on some issues, others remain for decision.

**SECTION 2-406. SALE ON APPROVAL AND SALE OR RETURN;
SPECIAL INCIDENTS.**

(a) If delivered goods conform to the contract and may be returned by the buyer, the transaction is:

- (1) a “sale on approval, if the goods are delivered primarily for use; or
- (2) a “sale or return, if the goods are delivered primarily for resale.

(b) Under a sale on approval:

(1) the risk of loss and the title to goods identified by the contract do not pass to the buyer until acceptance;

(2) use of the goods consistent with the purpose of trial is not acceptance, but a failure seasonably to notify the seller of election to return the goods is acceptance, and acceptance of any part of conforming goods is acceptance of the whole; and

(3) after seasonable notification of election to return, the return is at the seller's risk and expense, but a merchant buyer must follow any reasonable instructions.

(c) Under a sale or return:

(1) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition but must be exercised seasonably; and

(2) the return is at the buyer's risk and expense.

(d) An “or return” term of a contract for sale negates the sale aspect of the contract within the provisions of this [article] on parol or extrinsic evidence:

[(e) Subject to Section 2-407, goods held on approval are not subject to claims of a buyer's creditors until acceptance. However, goods held on sale or return are subject to those claims while in the buyer's possession.]

SOURCE: Sales, Section 2-320 (December, 1994)

Notes

1. Section 2-406 has been revised to include all material on the nature and the special incidents of “sale or return” and “sale on approval” in one section. Thus, old Section 2-327 has been rolled into Section 2-406 and the material on consignments and creditor's rights, previously in Section 2-326, now appears as Section 2-407. **Note, however, that the Drafting Committee, at the March, 1996 meeting, voted to move the rights of a consignor against creditors of a consignee from bracketed Section 2-407, below, to Article 9.**

2. New Section 2-406(e) [bracketed] preserves the traditional creditor's rights distinction between “approval” and “return” but states clearly that both transactions are subject to Section 2-407. Thus, even if the sale is on approval, Section 2-407 applies if the goods are delivered to a “person who deals in goods of that kind under a name other than the name of the person making delivery for the purpose of sale.” **A still unresolved question, after the decision to move consignments to Article 9, is the status of the so-called “sale or return” transaction. Should this be treated as a consignment? If so, what parts should be governed by Article 9? If not, what should the Article 2 rule for creditor's rights be?**

[SECTION 2-407. CONSIGNMENT SALES AND RIGHTS OF CREDITORS.

(a) Except for goods valued at \$1,000 or less and goods delivered to an auctioneer, if goods are delivered to a person who deals in goods of that kind under a name other than the name of the person making delivery for the purpose of sale, the goods are subject to claims of creditors while in the possession of that person unless the requirements of subsection (b) are satisfied. This subsection applies even if an agreement purports to reserve title to the person making delivery until payment or resale or uses words such as “on consignment” or “on memorandum.

(b) A person making a delivery subject to subsection (a) has priority in the goods and any proceeds of sale over creditors of the person to whom the goods were delivered, if the person making delivery:

(1) establishes that the person to whom the goods were delivered is generally known by its creditors to be substantially engaged in selling the goods of others; or

(2) complies with Section 9-114(a) or complies with the requirements for perfecting a security interest in the goods, to the extent provided in Section 9-114(a) or otherwise in [Article] 9.]

SOURCE: Sales, Section 2-321 (December, 1994)

Notes

Section 2-407 (Section 2-321 of the May, 1994 Draft) derives from Section 2-326 of the 1990 Official Text. **In March, 1996 the Article 2 Drafting Committee voted to delete Section 2-407 and move the consignment problem to Article 9.** Under tentative proposals, revised Article 9 now: (1) Defines consignment and defines security interest to include a consignment, whether or not for security; (2) Applies to “any consignment”; (3) Requires perfection of a consignment security interest and prescribes how a consignor may file a financing statement; (4) Defines the rights of creditors of and purchasers from the consignee; and (5) Defers consideration of the duties and remedial rights of the consignor upon default by the consignee.

PART 5

PERFORMANCE

SECTION 2-501. GENERAL OBLIGATIONS; SUBSTANTIAL PERFORMANCE.

(a) Parties to a transaction subject to this [article] are obligated to perform in accordance with the contract and this [article].

(b) Except as otherwise provided in this [article], a party's duty to perform is contingent on the other party's substantial performance of any of its obligations under the contract that precede in time the particular performance of the first party.

(c) Nonmaterial breach by one party of its obligations or duties under a contract does not in itself justify a refusal by the other party to perform its further obligations under the contract or cancellation of the contract but entitles the aggrieved party to the appropriate remedies described in this [article].

SOURCE: Licenses, Sections 2-2212, 2213 (September, 1994); Restatement (Second) Contracts § 237; Section 2A-523(2); Sales, Section 2-301 (December, 1994)

Notes

1. Subsection (a) is taken from Section 2-301 of the December, 1994 Draft. See CISG Articles 30 and 53.

2. Drawing on Section 2-602, which defines “material breach, subsection (b) states that subject to this article (and unless otherwise agreed) one party's duty to perform is contingent upon the other party's substantial performance of its obligations if the other party is to perform first. See Restatement (Second) Contracts § 237. The “perfect tender rule, however, is preserved for the rejection remedy. See Section 2-603.

3. The effect of a non-material breach, which follows general contract law, is stated in subsection (c). The aggrieved party may wish to invoke the adequate assurance mechanism in Section 2-612.

SECTION 2-502. QUALITY OF PERFORMANCE. If the quality of performance required under a contract is not fixed by or determinable from the express terms of the contract or from warranties made by the seller, the party shall render performance of a quality that is reasonable and not less than average under the circumstances.

SOURCE: UNIDROIT Article 5.6

Notes

This section is new and operates as a backup principle in the absence of clear agreement on performance standards. It would not, however, apply where the seller made warranties under Sections 2-313 through 2-318 in Part 3.

SECTION 2-503. SUPPORT CONTRACTS.

(a) A seller is not required to provide support or instruction for the buyer's use of goods after the initial delivery.

(b) If a seller agrees to provide support to the buyer, the seller shall make the support available at a time and place and with a quality consistent with:

(1) the terms of the contract; and

(2) to the extent not dealt with by the terms of the contract, in a commercially reasonable and workmanlike manner in light of ordinary standards of the trade and industry for the particular type of contract.

(c) In the case of a breach, [Part] 7 applies with respect to cancellation of the contract and the buyer's remedies for breach.

(d) A seller's breach does not entitle the buyer to cancel the contract concerning the goods unless the breach substantially impairs the value of the contract to the buyer.

SOURCE: Licenses, Section 2-2416 (September, 1994)

Notes

This section, which is new, has been approved in principle by the Drafting Committee. It and Section 2-504 apply when a party to the contract, usually the

seller, agrees to provide support or to maintain and repair goods. They are needed to fill gaps in the current Article 2.

SECTION 2-504. MAINTENANCE AND REPAIR OF GOODS.

(a) If a party agrees to provide replacement, repair, maintenance, or similar services in reference to goods associated with a contract, the following rules apply:

(1) If the services are provided by the seller for a limited time and in lieu of a warranty, the seller undertakes that its services will complete a delivery that conforms to the contract in a timely manner.

(2) In a case not governed by paragraph (1), a party who agrees to provide services must make the services available on a timely basis and in a workmanlike manner consistent with the terms of the contract and with commercially reasonable standards of the trade applicable to the type of services involved but does not guaranty that the services will correct defects or errors.

(b) A party receiving the services must cooperate to provide adequate opportunity for the service provider to complete the services and pay according to the contract terms for services received.

(c) In the case of a breach, [Part] 7 applies with respect to cancellation and the buyer's remedies for breach of the maintenance or repair contract.

(d) A seller's breach does not entitle the buyer to cancel the contract concerning the goods unless the breach substantially impairs the value of that contract to the buyer.

SOURCE: Licenses, Section 2-2417 (September, 1994)

Notes

1. This section, which is new, has been approved in principle by the Drafting Committee. It is a form of agreed "cure" which is common in the sale of complex, expensive goods.

2. Maintenance and repair agreements frequently take the form of limited, exclusive agreed remedies for breach of warranty. They are part of a broader

agreement that makes limited warranties, disclaims all other warranties and excludes liability for consequential damages. The failure to perform these agreements may cause a limited remedy to “fail of its essential purpose. Section 2-709(b). As Section 2-504 makes clear, that failure is also a breach for which appropriate remedies are available.

SECTION 2-505. WAIVER OF OBJECTION.

(a) A party who knows that the other party's performance constitutes a breach but accepts that performance and fails within a reasonable time to object is precluded from relying on the breach to justify rejection or to cancel the contract. However, acceptance and failure to object do not preclude any other remedy for breach unless the party in breach is prejudiced by the aggrieved party's inaction.

(b) In rejecting a tender or canceling a contract, a party's failure to particularize a defect that is known to it precludes that party from relying on the defect to justify rejection or cancellation if:

(1) stated seasonably, the other party could have cured the defect; or

(2) between merchants, the other party, after rejection or cancellation, has made a request in a record for a full and final recorded statement of all defects on which the rejecting or canceling party proposes to rely.

(c) A party's failure to reserve rights when paying or transferring other consideration against documents precludes recovery of the payment or transfer for defects apparent on the face of the documents.

SOURCE: Licenses, Section 2-2420 (September, 1994)

Notes

1. This section is new and has not been approved by the Drafting Committee. Also, its implications for sales law have not been fully explored.

2. Subsection (a), which deals with the failure to object to a breach should be compared to Section 2-210, which deals in part with the waiver of a term in a contract, such as an express condition precedent. Although the line is difficult to draw, both deal with the failure to object to an existing breach or failure of condition rather than to “waive a future performance.

SECTION 2-506. MANNER OF SELLER'S TENDER OF DELIVERY.

(a) To tender delivery, a seller shall put and hold conforming goods at the buyer's disposition and give any notification reasonably necessary for the buyer to take delivery. Tender must be at a reasonable hour. A tender of goods must be kept available for the period reasonably necessary to enable the buyer to take possession. The buyer shall furnish facilities reasonably suited to receive the goods.

(b) If the seller is required or authorized to send the goods to the buyer but the contract does not require delivery at a particular destination, tender requires that the seller deliver conforming goods to the carrier and comply with Section 2-507.

(c) If the contract requires the seller to deliver at a particular destination, tender requires compliance with subsection (a) and, in an appropriate case, the tender of documents as described in subsections (d) and (e). The seller need not deliver at a particular destination unless required by a specific agreement or by the commercial understanding of the terms used by the parties.

(d) If conforming goods are in the possession of a bailee and are to be delivered without being moved, the following rules apply:

(1) Tender requires the seller to tender a negotiable document of title covering the goods or to procure an acknowledgment by the bailee to the buyer of the buyer's right to possession of the goods.

(2) Tender to the buyer of a nonnegotiable document of title or of a record directing the bailee to deliver is sufficient unless the buyer seasonably objects. However, risk of loss of the goods and of any failure by the bailee to honor the document or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction. A refusal by the bailee to honor the document or to obey the direction defeats the tender. Receipt by the

bailee of notification of the buyer's rights fixes those rights as against the bailee and all third parties.

(e) If a contract requires the seller to deliver a document, the following rules apply:

(1) All required documents must be tendered in correct form, except as provided in this [article] with respect to bills of lading in a set.

(2) Tender through customary banking channels is sufficient, and dishonor of a draft accompanying the documents constitutes nonacceptance or rejection.

SOURCE: Sales, Section 2-503 (December, 1994)

Notes

1. Three minor changes were made in former Section 2-503. First, a test for interpreting delivery terms was added to subsection (c): Delivery to a particular destination must be required by “specific agreement” or the commercial understanding of the terms used. Second, the phrase “to the buyer” was added to subsection (d)(1). Third, a “tender” for purposes of Section 2-506 requires conforming goods.

2. With the repeal of the delivery terms in former Sections 2-319 through 2-323 in favor of a flexible interpretation standard, see Section 2-309, Section 2-506 becomes an important interpretive source for determining disputes over risk of loss under Section 2-516.

3. The seller's tender of delivery has two important consequences: First, it satisfies a condition to the buyer's duty to accept and to pay for the goods. See Section 2-510(a). Unless otherwise agreed, the buyer is not in breach until there is a tender of delivery. Compare Section 2-511, dealing with the buyer's tender of payment. Second, it is an essential ingredient in the passage of risk of loss under Section 2-516, in that tender either passes the risk or is an essential first step to transfer of possession of the goods. In either the case, the tender “rules,” in the absence of contrary agreement, must be clear and adapt to variations in delivery patterns, i.e., where seller has no obligation to ship the goods, or seller is authorized or required to ship the goods, or the goods are in the possession of a bailee. Interpretation of these requirements will be more difficult, since the delivery terms in former Sections 2-319 through 2-324 have been deleted.

4. **Definition of bailee.** Article 2 uses the word “bailee” in four sections, Sections 2-506(d), 2-516(2), 2-716(c), and 2-718(c), but does not define it. Neither does Article 2A. Article 1 uses the word in a broader definition of document of title. Section 1-201(15). Article 7 defines “bailee” for “purposes of” this Article as “the person who by a warehouse receipt, bill of lading or other document of title

acknowledges possession of goods and contracts to deliver them. “Bailee” is used 11 times in Article 7. However, the concept of “bailee” is broader in Article 2 than in Article 7 since it is not limited to third persons in possession of goods who issue a document of title.

5. **The Haystack Hypo.** At the January, 1994 meeting, the following problem was posed. Suppose that the seller sells to the buyer a haystack located at a place other than the seller's place of business and controlled by the seller's agent (not a bailee.) The buyer intends to resell the hay to a third party, who will then take delivery. The current rules appear to be adequate for this problem. The place for tender is the place where the goods are located, Section 2-305(2), [CISG Article 31(b) is in accord] and the adequacy of the tender of delivery is governed by Section 2-506(a). In the resale between the buyer and the resale buyer, since the goods are in the possession of a bailee (original seller's agent) and are to be delivered without being moved, tender by the buyer (now a seller) is governed by Section 2-506(d). No revisions are required.

6. **CISGA.** Under Article 30, the seller must “deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and this Convention. Articles 31-34 then state when and how this is to be done, with Article 31 the counterpart of Section 2-506 and Article 32 the counterpart of Section 2-507.

Article 31(b) deals with the case where no carriage of the goods is involved and the “contract relates to specific goods, or unidentified goods to be drawn from a specific stock or to be manufactured or produced, and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place. Here the delivery obligation is satisfied by “placing the goods at the buyer's disposal at that place, whether it be a place controlled by the seller but not its place of business or by a bailee.

Where that place is controlled by the seller, the same result can be reached through Sections 2-305(1) and 2-506(a).

SECTION 2-507. SHIPMENT BY SELLER.

(a) If a seller is required or authorized to send the goods to the buyer and the contract does not require delivery at a particular destination, the seller shall:

(1) put the goods in the possession of a carrier and make a reasonable contract for their transportation, having regard to the nature of the goods and other circumstances;

(2) obtain and promptly deliver or tender in due form any documents necessary or required by the agreement or by usage of trade to enable the buyer to obtain possession of the goods; and

(3) promptly notify the buyer of the shipment.

(b) Failure to notify the buyer under subsection (a)(3) or to make a proper contract under subsection (a)(1) is a ground for rejection only if material delay or loss results.

SOURCE: Sales, Section 2-504 (December, 1994)

Notes

1. There are no substantive changes in former Section 2-504. At the January, 1994 meeting of the Drafting Committee, however, Section 2-507 was criticized as out of step with the real commercial world. Normally, the seller is not expected to make arrangements for shipment unless required by the contract or commercial practice. It was suggested that CISG Articles 31(a) and 32 were more consistent with current practice. This issue should be resolved.

2. **CISGA.** Many international contracts for sale involve “carriage of the goods. In the absence of agreed delivery terms, such as the Incoterms of the International Chamber of Commerce, Articles 31(a) and 32 determine what the seller must do to deliver the goods. In the absence of agreement to deliver at “any other particular place, delivery consists of “handing the goods over to the first carrier for transmission to the buyer. Article 31(a). If the goods are “clearly identified to the contract the seller need **not** notify the buyer of the “consignment. Article 32(1). But see Section 2-509(a)(3) (unless otherwise agreed seller must promptly notify the buyer of the shipment). More to the point, unless the seller is “bound to arrange for carriage of the goods it need not make any contracts for carriage. Article 32(2). Even if the seller is not bound to obtain insurance on the carriage, it must “at the buyer's request, provide ... all available information necessary to enable [the buyer] to effect such insurance. Article 32(3).

SECTION 2-508. SELLER'S SHIPMENT UNDER RESERVATION.

(a) If a seller has identified goods to the contract by or before shipment, the following rules apply:

(1) Procurement of a negotiable bill of lading to the seller's order or otherwise reserves in the seller a security interest in the goods. Procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(2) Procurement of a nonnegotiable bill of lading to the seller or its nominee reserves possession of the goods as security. However, except in a case of

conditional delivery, a nonnegotiable bill of lading naming the buyer as consignee does not reserve a security interest, even if the seller retains possession of the bill of lading. The consignee is the person named in the bill of lading to whom or to whose order the bill promises delivery.

(b) A shipment by a seller with reservation of a security interest which breaches the contract for sale constitutes an improper contract for transportation under Section 2-507. However, rights given to the buyer by shipment and identification of the goods to the contract and the seller's powers as a holder of a negotiable document are not thereby impaired.

SOURCE: Sales, Section 2-505 (December, 1994)

Notes

1. There are no changes of substance in former Section 2-505.

2. **CISGA.** There is no comparable provision in CISGA. Article 58(1) and (2), however, permits a seller in cases where documents are involved to make payment a condition for handing over the goods or the documents. Nevertheless, the buyer may still examine the goods before payment unless otherwise agreed. Article 58(3).

SECTION 2-509. RIGHTS OF FINANCING AGENCY.

(a) A financing agency, by paying or purchasing for value a draft that relates to a shipment of goods, acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it, any rights of the shipper in the goods, including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(b) The right to reimbursement of a financing agency that has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by later discovery of defects in any relevant document that was apparently regular on its face.

SOURCE: Sales, Section 2-506 (December, 1994)

Notes

There are no changes in Section 2-509.

SECTION 2-510. EFFECT OF SELLER'S TENDER; DELIVERY ON CONDITION.

(a) Tender of delivery is a condition to a buyer's duty to accept and to pay for the goods. Tender entitles the seller to acceptance of the goods and to payment according to the contract. The seller shall tender first but has no duty to complete delivery until the buyer has tendered payment.

(b) Subject to Section 2-716, if payment is due and demanded on the delivery of goods or documents of title, a buyer's right against the seller to retain or dispose of them is conditional upon the buyer's making the payment due.

SOURCE: Sales, Section 2-507 (December, 1994)

Notes

1. There are two substantive changes in revised Section 2-510.

First, the second sentence in Section 2-510(a) provides that the seller rather than the buyer shall tender first, unless otherwise agreed. See Sections 2-501(b) and 2-511. But the seller has no duty to transfer possession until the buyer has tendered payment. If no time for tender is agreed, it must be made within a reasonable time.

Second, subsection (b) preserves the seller's right to reclaim from the buyer upon conditional delivery in a cash sale, but refers to Section 2-716 for limitations on their exercise against the buyer and third persons. These limitations are consistent with the recommendations in PEB Commentary #1, cited in Official Comment 3.

2. **CISGA.** Article 58(1), in accord, provides that if the buyer is "not bound to pay the price at any other specific time, he must pay it when the seller places either the goods or documents controlling their disposition at the buyer's disposal in accordance with the contract and this Convention. If, however, the buyer must pay "on the date fixed by or determinable from the contract and this Convention, it must pay "without the need for any request or compliance with any formality on the part of the seller. Thus, if no time is fixed to pay the seller must tender first. But if a time for payment is fixed, the buyer must pay at that time whether the seller tenders or not.

SECTION 2-511. TENDER OF PAYMENT BY BUYER; PAYMENT BY CHECK.

(a) Subject to Section 2-510(a), tender of payment by a buyer is a condition to the seller's duty to complete a delivery.

(b) Tender of payment by a buyer is sufficient if made by any means or in any manner current in the ordinary course of business unless the seller demands payment in money and gives any extension of time reasonably necessary to procure it.

(c) Subject to Section 3-310, payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

SOURCE: Sales, Section 2-511 (December, 1994)

Notes

1. There are no revisions of substance in Section 2-511. Under revised Section 2-510(a), however, unless otherwise agreed the seller must tender delivery before the buyer has a duty to tender payment and under Section 2-513(a) the buyer has a right to inspect the goods before payment or acceptance.

2. **CISGA.** Article 53 provides that the buyer “must pay the price for the goods ... as required by the contract and this Convention. It is frequently agreed that payment shall be by a letter of credit, a method of payment not within the scope of the Convention. In the absence of contrary agreement, questions about the time of payment are answered in Articles 58 and 59. If a time for payment has not been fixed, the duty to pay arises when the seller tenders delivery. Article 58(1) and (2). If a time for payment is fixed, the buyer must pay at the time “without the need for any request or compliance with any formality on the part of the seller.

SECTION 2-512. PAYMENT BY BUYER BEFORE INSPECTION.

(a) If a contract requires payment before inspection, nonconformity of the goods does not excuse the buyer from so making payment unless:

(1) the nonconformity appears without inspection; or

(2) despite tender of the required documents, the circumstances would justify injunction against honor under Section 5-109(2)(b).

(b) Payment pursuant to subsection (a) is not an acceptance of goods and does not impair a buyer's right to inspect or other remedies of the buyer.

SOURCE: Sales, Section 2-512 (December, 1994)

Notes

1. There are no changes of substance in former Section 2-512.

2. **CISG.** Article 58(3) protects the buyer's right to examine the goods before paying the price “unless the procedures for delivery or payment agreed upon by the parties are inconsistent with his having such an opportunity. Assuming such agreement, there is no provision comparable to Section 2-512.

SECTION 2-513. BUYER'S RIGHT TO INSPECT GOODS.

(a) If goods are tendered or delivered or identified to a contract for sale, a buyer before payment or acceptance, has a right to inspect them at any reasonable place and time and in any reasonable manner. If the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(b) Expenses of inspection must be borne by a buyer but may be recovered from the seller if the goods do not conform and are rejected.

(c) Subject to Section 2-512(a), a buyer is not entitled to inspect the goods before payment of the price if the contract provides for:

(1) delivery “C.O.D. or on similar terms; or

(2) payment against documents of title, unless payment is due only after the goods become available for inspection.

(d) A place or method of inspection fixed by the parties is presumed to be exclusive. However, unless otherwise expressly agreed, the fixing of a place or method of inspection does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection must be made as provided in this section unless the place or method fixed was clearly intended as an indispensable condition the failure of which avoids the contract.

SOURCE: Sales, Section 2-513 (December, 1994)

Notes

1. There are no changes of substance in former Section 2-513.

2. **CISGA.** Unless otherwise agreed, the buyer has a right to examine the goods upon tender and before payment. Article 58(3). If carriage of the goods is involved, examination “may be deferred until after the goods have arrived at their destination. Article 38(2). A special rule applies when the goods are redirected or redispached in transit. Article 38(2).

The buyer must act fast to examine the goods, Article 38(1), and may lose the right to rely upon a non-conformity if timely notice, as defined in Article 39, is not given. The buyer, however, is protected from the rigors of Articles 38 and 39 if the seller knew “or could not have been aware of the non-conformity and did not disclose it, Article 40, and is entitled to damages if “he has a reasonable excuse for his failure to give the required notice.

SECTION 2-514. WHEN DOCUMENTS DELIVERABLE ON

ACCEPTANCE OR PAYMENT. Documents against which a draft is drawn must be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment. Otherwise, delivery is required only on payment.

SOURCE: Sales, Section 2-514 (December, 1994)

Notes

1. There are no revisions of substance in Section 2-514. “Acceptance in the text of Section 2-513 means “acceptance as defined in Section 3-409(a) – a “signed agreement to pay a draft as presented – rather than “acceptance as defined in Section 2-607. See Section 4-503(1), dealing with documentary drafts presented to a bank.

2. There is no comparable provision in either Article 2A or CISGA.

**SECTION 2-515. OPEN TIME FOR PAYMENT OR RUNNING OF
CREDIT; AUTHORITY TO SHIP UNDER RESERVATION.**

(a) Payment is due at the time when and place where the buyer is to receive the goods, even if the place of shipment is the place for tender of delivery.

(b) If the seller is authorized to send the goods, the seller may ship them under reservation and may tender the documents of title. However, the buyer may

inspect the goods after their arrival before payment is due unless inspection is inconsistent with the terms of the contract.

(c) If tender of delivery is agreed to be made by way of documents of title, payment is due at the time and place where the buyer is to receive the documents regardless of where the goods are to be received.

(d) If the seller is required or authorized to ship the goods on credit, the credit period runs from the time of shipment. However, postdating the invoice or delaying its dispatch correspondingly delays the starting of the credit period.

SOURCE: Sales, Section 2-310 (December, 1994)

Notes

There are no revisions of substance in former Section 2-310.

SECTION 2-516. RISK OF LOSS.

(a) Except as otherwise provided in subsections (b), (c), and (d), the risk of loss passes to the buyer upon receipt of the goods. If the buyer does not intend to take possession, risk of loss passes to the buyer when it receives control of the goods.

(b) If a contract requires or authorizes a seller to ship goods by carrier, the following rules apply:

(1) If the contract does not require delivery at a particular destination, the risk of loss passes to the buyer when the goods are tendered and delivered to the carrier as required by Sections 2-506 and 2-507, even if the shipment is under reservation.

(2) If the contract requires delivery at a particular destination and the goods arrive there in the possession of the carrier, the risk of loss passes to the buyer when the goods are tendered as required by Section 2-506 so as to enable the buyer to take delivery.

(3) If a tender of delivery of goods or documents fails to conform to this [article] or to the contract, the risk of loss remains on the seller until cure or acceptance.

(c) If goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer:

(1) on the buyer's receipt of a negotiable document of title covering the goods or copies;

(2) on acknowledgment by the bailee to the buyer of the buyer right to possession of the goods or copies; or

(3) after the buyer's receipt of a nonnegotiable document of title or record directing delivery, as provided in Section 2-506(d)(2).

(d) This section is subject to Section 2-406.

SOURCE: Sales, Sections 2-509, 2-510 (December, 1994)

Notes

A number of changes have been made in former Section 2-509. In addition, Section 2-510 dealing with the effect of breach on risk of loss has been repealed.

1. The basic principle, now stated in subsection (a), is that risk of loss passes when the buyer receives or takes control of the goods, whether the seller is a merchant or not. Previously, former Section 2-509(3) drew an unpersuasive distinction between the merchant and non-merchant seller. Under revised subsection (a), risk remains on the seller, who is in the best position to either avoid the loss or insure against it, until the buyer takes possession or control of the goods.

To illustrate, suppose that S contracts to sell B a haystack located in a field and controlled by S's agent, who is not an independent bailee. The goods are identified to the contract but B never expects to take possession. Rather, B expects to resell the hay to a third person, who will then take possession. In this case, when S tenders delivery under Section 2-506(a), B, although not in possession, has control of the goods and the risk of loss has passed. The fact that B may be in breach of contract after tender but before possession is taken is irrelevant.

2. Subsection (b) applies in shipment contracts and risk of loss depends upon whether the contract requires delivery to a particular destination or not. This determination is made less certain by the deletion of the shipment terms in former Section 2-319, see Section 2-309, but is assisted by a new provision in Section 2-506(c) which, in effect, creates a presumption against the destination interpretation.

Risk of loss will not pass in a shipment contract unless the tender requirements of Sections 2-506 and 2-507 have been satisfied. Since tender requires conforming goods or documents, the delivery of non-conforming goods to the carrier will not pass the risk, even though the other requirements of Section 2-507 are satisfied. Thus, the risk remains on the seller until “cure or acceptance. Subsection (a)(3). After acceptance, the risk remains on the buyer even though there is a rightful revocation of acceptance and the loss occurs thereafter. See Section 2-510(2) of the 1990 Official Text, which has been repealed.

For risk of loss purposes, the term “carrier” in Section 2-516(1) does not include transportation facilities operated or controlled by the parties to the contract. Rather, the term “carrier” refers to independent methods of transportation by ground, air or water and could include the United States Postal Service. Otherwise, the risk of loss could shift to the buyer while the seller still has possession and control of the goods.

3. Subsection (d)(2) now provides that risk of loss passes on acknowledgment by the bailee “to the buyer” that the buyer has a right to possession. This phrase did not appear in former Section 2-509(3). A similar requirement appears in Section 2-506(c)(1). See *Jason's Foods, Inc. v. Peter Eckrich & Sons, Inc.*, 774 F.2d 214 (7th Cir. 1985).

For risk of loss purposes, the term “bailee” usually refers to a third person (neither seller nor buyer) who is in possession of the goods sold at the time of contracting. That person may be a warehouse or a carrier which has issued a document of title, see Section 7-102(1)(a), or another person who satisfies the requirements of a bailment. It is clear that a seller, after the contract for sale, may become a bailee of the goods either before or after the buyer takes possession. For example, suppose that S sells B a horse. B pays the price, but instead of taking delivery, B contracts with S to board the horse for an agreed price. S is now a bailee. Whether B has the risk of loss, however, should not be determined by Section 2-516(b). Instead, the question is whether B has the risk of loss under either Section 2-516(a) or Section 2-516(c) before S becomes a bailee. Since no shipment was contemplated and B never received the goods, risk remains on S unless S has obtained a contrary agreement per Section 2-516(d).

4. Former Section 2-510, dealing with the effect of breach on risk of loss, has been repealed. The only remnant is former Section 2-510(1), which now appears in subsection (a)(3), where the seller retains the risk of loss to nonconforming goods until “cure or acceptance. Beyond this the normal risk of loss rules apply.

Except for a tender of non-conforming goods, the assumption that a breach by either the seller or the buyer should, in cases of a deficiency in insurance coverage, reallocate the risk of loss otherwise assigned by Section 2-516 is dubious, especially where there is no causal connection between the breach and the loss itself. Absent a causal connection, the non-breaching party is still in the best position, cost considered, to avoid or insure against the loss.

Moreover, application of the “breach” standard in old Section 2-510 produced unexpected difficulties. For example, under Section 2-510(2), suppose the buyer in possession discovers a nonconformity in the goods and “rightfully

revokes acceptance before the loss occurs. Assuming that the buyer exercised ordinary care and did not owe the price, the operation of Section 2-510(2) was unclear. Suppose that the fair market value of the goods was \$1,000 and the buyer was either (a) fully insured, or (b) half insured or (c) not insured at all. Since B, after revocation, must return the goods or their fair market value to the seller, the practical solution is that buyer pays seller \$1,000 in (a), \$500 in (b) and nothing in (c). But there is nothing in the text of or Comments to Section 2-510(2) that dictated this result.

Similarly, under Section 2-510(3), suppose the buyer breaches while the goods are in the seller's or a bailee's possession and before the risk of loss has passed. It is unlikely that the buyer owes the price of the goods. Suppose the fair market value of the goods is \$1,000, the seller is not insured at all, and wants to recover that deficiency in "effective insurance coverage" from the buyer. Does Section 2-510(3) support an action against the buyer for \$1,000 and, if so, on what theory? Again, neither the text nor the Comments are helpful.

Finally, Section 2-510 was an anti-subrogation provision, since insurance "deficiency" was determined without regard to subrogation rights. Once the chips have fallen in the reallocation process, the insurance company, if any, must live with the outcome. But there is no evidence that insurance companies were aware of Section 2-510, much less that they calculated premiums with the availability of subrogation in mind.

5. **CISGA.** "Passing of Risk" is treated in Articles 66-70.

Article 67(1), dealing with "carriage of the goods," is comparable to Section 2-516(b). The distinction between "origin" and "destination" contracts, however, is not made. The question is whether the seller agreed to deliver to a carrier at a "particular" place. The answer may come from Incoterms used by the parties.

Article 68, dealing with goods sold in transit, has no exact counterpart in Section 2-516, the closest provision being Section 2-516(b). Furthermore, there is no provision like Section 2-516(c), which treats goods in the possession of a bailee.

Cases not otherwise covered are picked up in Article 69, which is CISG's equivalent to Section 2-509(3). Even between commercial parties, the buyer, in some cases, may have the risk of loss before taking possession of the goods. See Article 69(2). Article 69 presumably covers the "haystack" hypo and bailment cases.

Breach of contract is relevant to passage of risk under CISGA. For example, if risk has passed to the buyer and the goods are lost or damaged thereafter, the obligation to pay the price is discharged if "the loss or damage is due to an act or omission of the seller." Article 66. Also, under Article 69(1) risk passes to the buyer before possession is transferred regardless of any deficiency in insurance coverage if the buyer "commits a breach of contract by failing to take delivery." But a breach by the seller apparently does not prevent or reallocate the passage of risk. Rather, risk passes if the conditions of Articles 67-69 are satisfied but the "remedies available to the buyer on account of the breach" are not impaired. Article 70.

PART 6
BREACH, REPUDIATION, AND EXCUSE

SECTION 2-601. BREACH GENERALLY.

(a) Whether a party is in breach is determined by the contract and, in the absence of contractual terms, by this [article].

(b) A breach occurs in the following circumstances among others:

(1) A seller is in breach if it fails to deliver or to perform an obligation, makes a nonconforming tender of performance, repudiates the contract, or exceeds a contractual limitation.

(2) A buyer is in breach if it wrongfully rejects a tender of delivery, wrongfully revokes acceptance, excuse repudiates the contract, fails to make a required payment or to perform an obligation, or exceeds a contractual limitation.

SOURCE: Licenses Section 2-2108(8), (September, 1994); Sales Section 2-701 (December, 1994)

Notes

1. Section 2-601 brings the definition of breach previously found in Section 2-701 (May, 1994 Draft) to Part 6 and revises it slightly for broader application. Thus, definitions of breach are no longer contained in the statement of seller's and buyer's remedies in Sections 2-715 and 2-723. The word "default" is not used in Article 2.

2. Whether the conduct of the seller or buyer is a breach is also determined by whether the alleged repudiation or non-performance is excused. Grounds for excuse are stated at various places in this article. See, e.g., Sections 2-615 through 2-618.

**SECTION 2-602. BREACH OF THE WHOLE CONTRACT;
SUBSTANTIAL IMPAIRMENT.**

(a) A breach is a breach of the whole contract if the contract so provides or if the circumstances indicate that the value of the contract to the other party has been substantially impaired.

(b) In determining whether there is a breach of the whole contract, the court may consider whether:

- (1) the aggrieved party has been deprived of the benefit that it reasonably expected under the contract;
- (2) cure of the breach is possible and likely;
- (3) Adequate assurance of due performance has been given; and
- (4) the breaching party acted in bad faith;

(c) Individual breaches that alone do not breach the whole contract under subsection (a) may be treated as a breach of the whole if cumulatively they substantially impair the value of the contract to the other party.

SOURCE: Restatement (Second) of Contracts Section 241; Licenses, Section 2-2106 (September, 1994)

Notes

1. This section provides guidance on when a breach is of the “whole contract. The question is whether the breach substantially impairs the value of the contract to the other party. The answer emerges from the surrounding circumstances and the factors indicated in subsections (a) and (b). See Section 241 of the Restatement, Second, of Contracts.

2. In the absence of agreement, the primary factors for a court to consider are stated in subsection (b). Additional considerations include the extent to which: (a) the terms of the contract indicate that the performance to which the breach relates is important to one or more of the parties; (b) the injured party can be adequately compensated for the benefit of which it will be deprived; and (c) the party breaching the contract will suffer a unjustified forfeiture if the breach is treated as material.

SECTION 2-603. BUYER'S RIGHTS ON NONCONFORMING DELIVERY; RIGHTFUL REJECTION.

(a) Subject to Sections 2-507 and 2-611, if the goods or the tender of delivery fail in any respect to conform to the contract, a buyer may:

- (1) reject the whole;
- (2) accept the whole; or

(3) accept any commercial unit or units and reject the rest.

(b) A rejection under subsection (a) is not effective unless the seller is notified within a reasonable time after the nonconformity was or should have been discovered.

SOURCE: Sales, Section 2-601 (December, 1994)

Notes

1. Revised Section 2-603(a) states when the buyer can reject a non-conforming tender and Section 2-603(b), previously found in Section 2-602(1), requires timely notice for an effective rejection. A rejection not permitted under Section 2-603(a) is wrongful and a breach, see Sections 2-601(a)(1) and 2-715, even though prompt notice is given. A rejection that is rightful under Section 2-603(a) but not effective under Section 2-603(b) may be an acceptance under Section 2-607(a)(2).

2. Subject to various limitations stated in Section 2-603 and elsewhere, Section 2-603(a) preserves the perfect tender rule. There are, however, several limitations on the power to reject for an admitted non-conformity.

In addition to the notice requirement in subsection (b), subsection (a) permits the parties to vary the rejection standard by agreement. Further, the power to reject is limited by Sections 2-507 and 2-611, both of which require non-conformity of a more substantial nature.

Another statutory limitation is Section 1-203, which imposes an “obligation of good faith” in the “enforcement” of the contract. Since Rejection is clearly “enforcement” of the contract, its exercise is subject to the duty of good faith.

A practical limitation arises when the buyer fails to discover a non-conformity and accepts the goods. Section 2-607(a)(2). To revoke acceptance under Section 2-609, the non-conformity must substantially impair the value of the lot or unit accepted to the buyer.

Finally, even if the rejection is rightful and effective, the seller has a broad power to “cure” under revised Section 2-610. This limits the buyer's options to cancel the contract or to “cover” from a third party. Thus, for example, a buyer who in good faith rejects for a non-conformity that does not substantially impair the value of the contract to him cannot cancel the contract until the seller has had a reasonable opportunity to cure under Section 2-610(a)(2)(ii). Rejection, therefore, like a demand for adequate assurance under Section 2-612, is really a justified demand for “cure” under Section 2-610.

3. **CISG.** Under CISG, buyer remedies are triggered when the seller “fails to perform any of his obligations under the contract,” Article 45(1), and preserved when proper notice of the nonconformity is given under Article 39(1). There is no rejection remedy, however, and the buyer is required to pay the price as agreed unless the contract can be avoided for a “fundamental” breach. See Article 25.

Upon finding non-conforming goods, the buyer's remedial options include requiring the seller to deliver substitute goods or repair them under Article 46, fixing an additional length of time for the seller to perform under Article 47 and avoiding the contract for "fundamental breach" under Article 49. In addition, the seller has broad power to "cure" under Article 48.

Thus, although a minor non-conformity may be a breach for which rights and remedies are provided, the buyer cannot buy replacement goods (cover) under Article 75 unless the contract is avoided for fundamental breach.

SECTION 2-604. WAIVER OF BUYER'S OBJECTIONS BY FAILURE TO PARTICULARIZE.

(a) A buyer's failure to state, in connection with rejection under Section 2-603 or a revocation of acceptance under Section 2-609, a particular nonconformity that is ascertainable by reasonable inspection precludes reliance on the unstated defect to justify rejection or revocation of acceptance or to establish breach if:

(1) the seller would have cured the nonconformity if stated seasonably;

or

(2) between merchants, the seller after rejection or revocation of acceptance has made a request in a record for a full and final recorded statement of all nonconformities on which the buyer proposes to rely.

(b) Payment against a document made without a buyer's reservation of rights precludes recovery of the payment for defects apparent on the face of the document.

SOURCE: Sales, Section 2-602 (December, 1994)

Notes

1. Section 2-604 is taken from Section 2-605 of the 1990 Official Text. The move places it in closer proximity to the general notice required for an effective rejection, Section 2-603(b), and the more detailed requirements of Section 2-604.

2. Since the seller has a limited right to "cure" after a revocation of acceptance, Section 2-604 now imposes limitations upon an effective revocation of

acceptance under Section 2-609. These are in addition to the general notice requirement in Section 2-609(c). In an effort to reduce the risk that a revoking buyer will fail to comply with Section 2-604, it was suggested at the October, 1995 meeting of the Drafting Committee, that the word “would” replace “could” in line 1, page 101 of the October, 1995 Draft.

Section 2-604 is a particularized application of the principles in Section 2-505.

3. **CISG.** Article 39(1) provides that the buyer “loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it. Presumably, this failure to specify bars the use of that alleged non-conformity for all remedial purposes. Other related articles include Articles 39(2), 40, and 44.

The Drafting Committee rejected a motion to incorporate the provisions of Article 40, which provides that the seller is “not entitled to rely on the provisions of Articles 38 and 39 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer.

SECTION 2-605. EFFECT OF RIGHTFUL REJECTION AND JUSTIFIABLE REVOCATION OF ACCEPTANCE.

(a) Subject to Section 2-606, a buyer who, before rejection or revocation of acceptance, takes physical possession or control of goods other than those in which there is a security interest under Section 2-723(c), shall after a rightful rejection or justifiable revocation of acceptance hold the goods with reasonable care at the seller's disposition for a sufficient time to permit the seller to remove them. However, the buyer has no further obligation with regard to the goods.

(b) If a buyer uses the goods after a rightful rejection or justifiable revocation of acceptance, the following rules apply:

(1) Any use by the buyer which is inconsistent with the seller's ownership or with the buyer's claim of rejection or revocation of acceptance and is unreasonable under the circumstances is an acceptance if ratified by the seller.

(2) If use of the goods is not an acceptance, the buyer, upon returning or disposing of the goods, shall in appropriate circumstances pay the seller the

reasonable value of the use to the buyer. This value must be deducted from the sum of the price paid to the seller, if any, and any damages to which the buyer is otherwise entitled under this [article].

(c) A buyer in possession who wrongfully rejects but does not accept goods is subject to subsection (b)(1) and the duty of care in subsection (a).

SOURCE: Sales, Section 2-603 (December, 1994)

Notes

1. Subsection (a), which was subsection (2) in an earlier draft, is taken from Section 2-602(2)(b) and (c) of the 1990 Official Text. It states the duty of care of a non-merchant buyer in possession of goods after a rightful rejection or justified revocation of acceptance. It also covers a buyer in possession of wrongfully rejected but not accepted goods, i.e., a buyer who had no ground for rejection under Section 2-603(a) but effectively rejected under Section 2-603(b). See Section 2-605(d).

A buyer who first accepts the goods and then wrongfully revokes acceptance is treated as having accepted the goods and is liable for their price.

2. Subsection (b)(1) is taken from Section 2-602(2)(a) of the 1990 Official Text. The seller has the option to treat the listed unreasonable acts of ownership or control by the buyer as either an acceptance under Section 2-607(a)(3) or the tort of conversion.

3. Subsection (b)(2) is new. There was considerable discussion about the proper standard at the January, 1994 and March, 1995 meetings of the Drafting Committee. Although a reasonable use is not an acceptance, the buyer must pay the seller the reasonable value to the buyer of the use. One possible measure of value, not stated in the text, is what it would cost the buyer to obtain a comparable use from a similarly situated person in the seller's position. See Restatement, Second, Contracts § 371(a). But the buyer may offset or deduct that value from the sum of the price paid to the seller and any damages otherwise resulting from the breach. See Section 2-723(a), which permits the buyer to recover these amounts.

To illustrate, suppose the buyer, after testing, discovered that machinery supplied by the seller would not perform to its warranted capacity. A rightful and effective rejection was made. The seller elected not to cure and directed the buyer to dismantle and return the machine. The buyer, however, used the machine for three months and, because cover was not available during that time, the use was reasonable under the circumstances. Assuming that the reasonable value of the three months use to the buyer was \$5,000, the seller recovers nothing if the sum of the buyer's part performance (down payment plus interest) and damages resulting from the breach exceeds \$5,000. The buyer, of course, can recover that excess as damages, including provable incidental and consequential damages under Section 2-715.

4. **CISG.** See Articles 86-88, dealing with the buyer's duty to preserve the goods in certain circumstances.

SECTION 2-606. MERCHANT BUYER'S DUTIES; BUYER'S OPTIONS AS TO SALVAGE.

(a) Subject to a buyer's security interest under Section 2-723(c), if the seller does not have an agent or place of business at the market where the goods were rejected or acceptance was revoked, a merchant buyer, after rejection or revocation of acceptance, shall follow any reasonable instructions received from the seller with respect to goods in the buyer's possession or control and in the absence of those instructions shall make a reasonable effort to sell or otherwise dispose of them for the seller's account if they threaten to decline speedily in value. Instructions are not reasonable if on-demand indemnity for expenses is not forthcoming.

(b) A merchant buyer who sells goods under subsection (a) is entitled to reimbursement from the seller or out of the proceeds for the reasonable expenses of caring for and selling them. If the expenses do not include a sales commission, the buyer is entitled to a commission usual in the trade or, if there is none, to a reasonable sum not exceeding 10 percent of the gross proceeds.

(c) Subject to subsection (a), if a seller does not give instructions within a reasonable time after notification of rejection or revocation of acceptance, the buyer, whether a merchant or not, may store the rejected goods for the seller's account, reship them to the seller, or resell them for the seller's account, with reimbursement as provided in subsection (b).

(d) In complying with Section 2-605, a buyer shall act in good faith. Conduct in good faith under this section does not constitute acceptance or conversion and may not be the basis of an action for damages.

SOURCE: Sales, Section 2-604 (December, 1994)

Notes

1. Section 2-606 integrates in one section various strands of the buyer's post rejection and revocation duties with regard to the goods not otherwise covered in Section 2-605. Except for the addition of "revocation of acceptance" in subsections (a) and (c), no substantive changes are made in the 1990 Official Text. Subsection (a), taken from Section 2-603(1), and subsection (b), taken from Section 2-603(2), are limited to merchant buyers. Subsection (c), taken from Section 2-604, and subsection (d), taken from Section 2-603(3), apply to all buyers.

2. **CISG.** See Articles 86-88.

SECTION 2-607. WHAT CONSTITUTES ACCEPTANCE OF GOODS.

(a) Goods are accepted if a buyer:

(1) after a reasonable opportunity to inspect the goods, signifies to the seller that the goods conform or will be taken or retained in spite of their nonconformity;

(2) after a reasonable opportunity to inspect the goods, fails to make an effective rejection; or

(3) either before or after rejection or revocation of acceptance, does any unreasonable act inconsistent with the seller's ownership or the buyer's claim of rejection or revocation of acceptance and that act is ratified by the seller as an acceptance.

(b) Acceptance of a part of any commercial unit is acceptance of the entire unit.

SOURCE: Sales, Section 2-605 (December, 1994)

Notes

1. Section 2-607 (former Section 2-606) states what constitutes an acceptance of goods by the buyer.

Under subsection (a)(1), the buyer must first have a reasonable opportunity to inspect the goods and then objectively signify to the seller that they will be taken or retained. The buyer may or may not have discovered a nonconformity.

Under subsection (a)(2), the buyer must first have a reasonable opportunity to inspect the goods and then fail to make an effective rejection under Section 2-603(b). The classic case is where the buyer discovers a nonconformity but fails

to notify the seller of rejection within a reasonable time after delivery. A rejection would have been rightful under Section 2-603(a) but it was not effective under Section 2-603(b). Conversely, it is not an acceptance where the buyer effectively rejects for reasons not permitted under Section 2-603(a). Unless the buyer does an act of unreasonable ownership or control over the goods, see subsection (a)(3), a wrongful but effective rejection is a breach under Section 2-715 but not an acceptance under Section 2-607.

Does this make sense? Why not state simply and clearly that a wrongful rejection under Section 2-603(a), even though effectively communicated under Section 2-603(b), is an acceptance.

Subsection (a)(3) gives the seller an option to treat certain unreasonable acts by the buyer as an acceptance, whether they occur before or after rejection or revocation and whether the rejection was rightful or the revocation was justified. Thus, unreasonable use of goods during inspection could be an acceptance even though a subsequent rejection was otherwise proper. Similarly, an unreasonable use after a wrongful but effective rejection could also be an acceptance.

2. **CISG.** The remedies of the buyer for breach by a seller do not depend upon whether the buyer has accepted the goods.

**SECTION 2-608. EFFECT OF ACCEPTANCE; NOTICE OF BREACH;
BURDEN OF ESTABLISHING BREACH AFTER ACCEPTANCE; NOTICE
OF CLAIM OR LITIGATION TO PERSON ANSWERABLE OVER.**

(a) A buyer shall pay the contract rate for any goods accepted.

(b) Acceptance of goods by a buyer precludes rejection of the goods accepted but does not by itself impair any other remedy provided by this [article] for nonconformity.

(c) If a tender has been accepted, the following rules apply:

(1) The buyer, within a reasonable time after the buyer discovers or should have discovered a breach, shall notify the seller of the claimed breach.

However, a failure to give notice bars the buyer from a remedy only to the extent that the seller establishes that it was prejudiced by the failure.

(2) If the claim is one for infringement or the like and as a result of the breach the buyer is sued, the buyer shall so notify the seller within a reasonable

time after receiving notice of the litigation or be barred from any remedy over for liability established by the litigation.

(d) A buyer has the burden of establishing a breach with respect to goods accepted.

(e) If a seller is sued for breach of a warranty or other obligation for which the its seller is answerable over, the following rules apply:

(1) The seller may give its seller notice in a record of the litigation. If the notice invites its seller to intervene in the litigation and defend and states that if its seller does not do so its seller will be bound in any action against it by the seller by any determination of fact common to the two actions, its seller is so bound unless, after seasonable receipt of the notice, it intervenes in the litigation and defends.

(2) If the claim is one for infringement or the like, the original seller may demand in a record that its buyer turn over control of the litigation including settlement or otherwise be barred from any remedy over. If the seller also agrees to bear all expense and to satisfy any adverse judgment, the buyer is so barred unless, after seasonable receipt of the demand, control is turned over to the seller.

(f) Subsections (c), (d), and (e) apply to an obligation of a buyer to hold the seller harmless against infringement or the like.

SOURCE: Sales, Section 2-606 (December, 1994)

Notes

1. At the January, 1994 meeting, the Drafting Committee approved the following revisions in the draft before it:

(a) Replace “price” with “rate” in Section 2-608(a). This restores the 1990 Official Text. See Comment 1.

(b) Delete “materially” from Section 2-608(c)(1). Thus, the buyer who fails to give timely notice of breach is barred from any remedy to the extent that the seller is “prejudiced thereby.” The statute provides no guidance on when a seller is prejudiced.

(c) Restore the original language in Section 2-607(3)(b) to revised Section 2-608(c)(2). The “prejudice limitation was rejected for infringement claims.

(d) Replace “prove with “establish in Section 2-608(d), since “establish is defined in Section 1-201.

(e) Clarify the relationship of the parties in the “vouching in provision, Section 2-608(e)(1). See subsection (e)(1). The Drafting Committee has rejected a suggestion that the “vouching provision be deleted.

2. Notice by the buyer to the seller is important in three situations involving remedies: First, to make an effective rejection under Section 2-603(b); Second, to revoke acceptance under Section 2-609(b); and Third, to preserve a damage remedy for accepted goods under Section 2-608(b)(1). In the first case, the notice should state that the buyer is rejecting a non-conforming tender and the grounds for a possible cure by the seller, see Section 2-604. In the second case the notice should state that the buyer is revoking acceptance and the limited grounds for possible cure, see Section 2-609(b). In the third case the notice need state only that the buyer is claiming a breach, see Section 2-608(c)(1). Since neither cure nor the remedies of rejection and revocation are available when the third type of notice is given, the task of determining the impact on the seller of a failure to give notice is more complicated.

Subsection (c)(1), which imposes a statutory notice condition, states that a failure bars a remedy to the extent that the seller “establishes that it was prejudiced by the failure. This is a middle position between an absolute bar and requiring proof of material prejudice. See Restatement, Second, Contracts § 229, excusing a condition precedent where the failure is not material and implementation would result in “disproportionate forfeiture. The issue was discussed again at the October, 1995 meeting of the Drafting Committee but no changes were adopted.

3. **CISG.** Although the buyer is obligated to take delivery and pay the price “as required by the contract and this Convention, Article 53, the concept of acceptance is irrelevant to the obligations of either party. Thus, there is no need to state the “effect of acceptance.

SECTION 2-609. REVOCATION OF ACCEPTANCE.

(a) A buyer may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the buyer if accepted:

(1) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(2) without discovery of its nonconformity if acceptance was reasonably induced by the difficulty of discovery before acceptance or by the seller's assurances.

(b) To be effective, a buyer's acceptance must be revoked within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. The revocation is not effective until the buyer notifies the seller of it.

(c) A buyer who justifiably revokes acceptance has the same rights and duties with regard to the goods involved under Sections 2-605, 2-606, and 2-610 as if they had been rejected.

SOURCE: Sales, Section 2-607 (December, 1994)

Notes

1. There are no revisions of substance in Section 2-609 (formerly Section 2-608). Under Section 2-610(a), however, the seller now has power to cure a nonconformity when acceptance is revoked under subsection (a)(2). Thus, the buyer's notice of revocation is subject to Section 2-604 and the risk of failing to particularize a nonconformity.

2. Notes: (1) For when a breach substantially impairs the value of the contract to the other, see Section 2-602(b); (2) Although a wrongful rejection of acceptance is a breach of contract, the buyer is still liable for the price; and (3) When the revocation remedy survives a "failure of essential purpose is determined under Section 2-709.

3. Upon a justifiable revocation of acceptance, the seller has a right to cure as defined in Section 2-610. Note, however, that Section 2-609(a)(1) provides that revocation is proper when the goods were accepted on the reasonable assumption that a nonconformity would be cured and it is not cured. In this case, the seller would not have a second opportunity to cure under Section 2-610.

SECTION 2-610. CURE. If the buyer rightfully rejects a tender of delivery under Section 2-603 or justifiably revokes an acceptance under Section 2-609(a)(2), the seller, upon seasonable notice to the buyer and at its own expense, may cure any breach as follows:

(1) If the agreed time for performance has not expired, the seller may tender a conforming tender of delivery within the agreed time.

(2) If the agreed time for performance has expired, the seller may provide a cure that is appropriate in the circumstances if the buyer has no legitimate interest in refusing the cure and the cure is effected within a reasonable time.

SOURCE: Sales, Section 2-508 (December, 1994)

Notes

1. Section 2-610, which is taken from Article 7.1.4 of the Unidroit Principles, both expands and simplifies the seller's cure opportunity. This section was approved in principle by the Drafting Committee at the March, 1996 meeting. The Drafting Committee also rejected a motion to preclude cure by the seller after a revocation of acceptance.

Additional research and thought will be devoted to new Section 2-610 and its implications.

2. There are several changes in revised Section 2-610.

First, the seller's right to cure explicitly extends to an effective revocation under Section 2-609(a)(2). The seller does not have a "double right to cure. Thus, if the buyer effectively revokes under Section 2-609(a)(1) because the seller failed to make an agreed cure, Section 2-610 does not apply. Similarly, if the buyer effectively revokes acceptance after a limited remedy fails of its essential purpose, see Section 2-709(b), Section 2-610 does not apply. As a practical matter, the seller's right to cure after revocation of acceptance will be limited to Section 2-610(a)(2): The time for performance has probably passed and the non-conformity, to justify revocation, has already substantially impaired the value of the contract to the buyer. Subsection (a)(3), which applies to insubstantial breaches, does not apply to a revocation of acceptance.

Second, paragraph (1) is the same as Section 2-508(1) of the 1990 Official Text. It gives a broad right of cure when the time for performance has "not yet expired. Subsection (a)(2), however, applies when the time for performance has expired. The seller's cure, to be effective, must be "appropriate in the circumstances and effected within a "reasonable time and the buyer must have no "legitimate interest in refusing the cure.

To illustrate, consider the problem of delay in performance. Suppose the seller tenders delivery of conforming goods 10 days late and the buyer rightfully rejects because of the delay. Paragraph (1) is not applicable here because the time for performance has expired. Paragraph (2) applies after the time for performance has passed but, obviously, the seller cannot cure the delay itself. What has passed is past. In short, a second late tender by the seller is not "appropriate in the circumstances.

To illustrate further, suppose that the seller tenders non-conforming goods after the time for performance has expired and the buyer rejects because of non-conformity rather than the delay. The seller then promptly tenders goods that

conform in all respects to the contract. The cure is effective unless the buyer has a “legitimate interest in refusing it.

Third, the problem of cure in installment contracts, Section 2-611 (previously treated in Section 2-612(2) of the 1990 Official Text), is treated in Section 2-611. Note that cure is not available for substantial delay in performing an installment. Furthermore, the buyer must accept a non-conforming tender of goods if the seller “gives adequate assurance of cure.

2. At the January, 1994 meeting of the Drafting Committee, a motion to exclude consumer buyers from the scope of subsection (a)(2) was rejected.

3. Note that a rejection must be rightful under Section 2-603(a) and effective under Section 2-603(b) before Section 2-610 becomes operative. The phrase “rightful rejection is used to signal a proper rejection. A wrongful rejection is a breach of contract, see Section 2-715, and an ineffective rejection is an acceptance. If the rejection is proper and the seller gives notice of cure, the buyer must wait for the reasonable time necessary to evaluate the cure. If the cure is effective, the buyer must accept the tender and seek any damages resulting from the breach. If the cure is ineffective, the buyer may pursue its remedies under Section 2-723(1), including cancellation.

The buyer breaches if it deprives the seller of its statutory right to cure under Section 2-610 or fails to cooperate in good faith when the seller attempts to cure. See Section 2-307. Thus, if the buyer had a right to reject under Section 2-603(a) but canceled the contract without making an effective rejection, a breach has occurred. Similarly, the buyer fails to cooperate if, after the seller gives notice of an intention to cure, access to the goods is prohibited.

4. **CISGA.** Under CISGA, the buyer has no remedy of rejection for a nonconforming tender and cannot “avoid the contract unless the seller has committed a “fundamental breach, see Articles 49(1)(a) and 25. Upon a non-conforming tender however, the buyer can, in certain circumstances, require the seller to “cure by delivering substitute goods, Article 46(2) (must have a fundamental breach), or by repair, see Article 46(3). In addition, the buyer may “fix an additional period of time for the seller to perform, Article 47(1), and the seller has a broad, unified right to cure under Article 48(1).

SECTION 2-611. INSTALLMENT CONTRACT; BREACH.

(a) An “installment contract is a contract in which the terms require or the circumstances permit the delivery of goods in separate lots to be separately accepted, even if the contract requires payment other than in installments or contains a clause stating that “each delivery is a separate contract or its equivalent.

(b) The buyer may reject any nonconforming installment of delivery of goods or documents and the seller may reject any nonconforming installment of

payment if the nonconformity substantially impairs the value of that installment to the aggrieved party. However, if a non-conforming tender by the seller or buyer is not a breach of the whole contract, and the seller or buyer gives adequate assurance of its cure, the aggrieved party must accept that installment.

(c) If a nonconformity with respect to one or more installments substantially impairs the value of the whole contract, there is a breach of the whole. However, the power to cancel the contract for breach is waived or a canceled contract is reinstated if the aggrieved party accepts a nonconforming installment without seasonably notifying of cancellation, brings an action with respect only to past installments, or demands performance as to future installments.

SOURCE: Sales, Section 2-611 (December, 1994)

Notes

1. Subsection (a) clarifies the definition of installment contract. First, the definition includes cases where “circumstances give either party the right to make or demand delivery in lots. Section 2-302. Second, the definition includes cases where the goods are to be delivered and accepted in separate lots but payment is to be made in one lump sum. A contract where the goods are to be delivered in one lot but payment is to be made in installments, however, is not an installment contract under subsection (a).

2. Subsection (b) includes nonconforming installment payments by the buyer as well as non-conforming tenders of delivery by the seller. In an installment contract under subsection (a), the seller should have the option to reject a late or deficient installment payment if the breach substantially impairs the value of the installment to the seller. Similarly, the buyer's right to revoke acceptance of an installment under Section 2-609 is also available.

Unlike breach by the seller, the buyer has no statutory right to cure a breach in payment. In fact, a delay in payment cannot be cured. But a seller who makes an effective rejection under Sections 2-603(b) and 2-604 will have every incentive to encourage and accept a cure by the buyer in the form of full payment of the installment. Adequate assurance of full payment should not be enough.

Realistically, the seller will probably accept a late or deficient payment and reserve rights to damages or cancellation under Section 1-207. In these cases, there is no rejection. But the buyer should be notified of what has happened and required to make up deficiencies or to give adequate assurance of future timely payments. Allowing delays or deficiencies to cumulate may result in a breach of the whole contract under subsection (c).

3. Under subsection (c), the objective substantial impairment test for breach of the “whole” contract is retained. See Section 2-602. If there is a breach of the whole, the aggrieved party can cancel the contract. See Sections 2-715 and 2-723(a).

Subsection (c) is clarified by stating that the power to cancel the contract is waived and a canceled contract is reinstated by certain conduct by the aggrieved party. Section 2-612(3) stated only that the contract was “reinstated” by the aggrieved party's conduct, suggesting that the contract must first be canceled. See Section 2-505 dealing with “waiver” by failing to object.

4. **CISGA.** Article 73 governs a contract for “for delivery of goods by installments. Either party may avoid either a particular installment or the entire contract in defined cases of fundamental breach. See Article 25. The concept is consistent with Section 2-611 but the terminology is somewhat different.

SECTION 2-612. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party not to impair the other's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, the other may demand in a record adequate assurance of due performance and, until that assurance is received, if commercially reasonable, may suspend any performance for which the agreed return has not already been received.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered is determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a demand under subsection (a), failure to provide within a reasonable time, not exceeding 30 days, assurance of due performance which is adequate under the circumstances of the particular case is a repudiation of the contract.

SOURCE: Sales, Section 2-608 (formerly Section 2-609) (December, 1994)

Notes

1. There are no revisions in Section 2-612.

2. **CISG.** See Article 71(a), which recognizes a more limited principle of performance insecurity. A party suspending performance under Article 71(a) must notify the other party “immediately” and must continue with performance “if the other party provides adequate assurance of his performance.” Article 71(3).

SECTION 2-613. ANTICIPATORY REPUDIATION.

(a) If either party to a contract repudiates a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(1) await performance by the repudiating party for a commercially reasonable time; or

(2) resort to any remedy for breach, even if it has urged the repudiating party to retract the repudiation or has notified the repudiating party that it would await the agreed performance; and

(3) in either case suspend its own performance or proceed in accordance with Section 2-717.

(b) Repudiation includes but is not limited to language that one party will not or cannot make a performance still due under the contract or voluntary affirmative conduct that reasonably appears to the other party to make a future performance impossible or apparently impossible.

SOURCE: Sales, Section 2-609 (formerly Section 2-610) (December, 1994)

Notes

1. Revised Section 2-613 (formerly Section 2-610) makes two important changes.

First, a working but not exclusive definition of repudiation, taken from § 250 of the Restatement, Second of Contracts, is provided in subsection (b). This is in addition to that provided in Section 2-612(d) (formerly Section 2-609) and would include an unqualified statement that one party will not perform the contract unless the other agrees to an unjustified modification of the contract. Less clear are qualified statements, such as “I will not perform the next installment of the contract

until a good faith dispute over contract interpretation is resolved. Arguably such qualified statements are repudiations which do not substantially impair the value of the contract to the other.

Second, it is now clearer that repudiation of a part performance (an installment) may constitute a substantial impairment of the whole contract to the other. Previously, the language of Section 2-610 stated that when “either party repudiates **the contract** with respect to a performance not yet due the loss of which will substantially impair the value of **the contract** to the other, the aggrieved party could take remedial action. Under the revision, repudiation of an installment “a performance not yet due can constitute a substantial impairment of the entire contract. See Section 2-611(c) (formerly Section 2-612).

2. If, under Section 2-613(a), the aggrieved party waits more than a commercially reasonable time for performance by the repudiating party and then sues for damages under either revised Section 2-721(a) or Section 2-726(a), the time for measuring the market price is now the time when the commercially reasonable time expired. This applies whether the case comes to trial before or after the agreed time for performance.

3. **CISG.** Article 72(1) states that if “prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided. Unless that party has “declared that he will not perform his obligations, Article 72(3), however, the other must give reasonable notice of an intention to avoid the contract in order to permit that party “to provide adequate assurance of his performance. Article 72(3). Adequate assurance presumably requires more than just a simple retraction of the repudiation.

SECTION 2-614. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) A repudiating party may retract a repudiation until its next performance is due unless the aggrieved party, after the repudiation, has canceled the contract, materially changed its position, or otherwise indicated that the repudiation is considered to be final.

(b) A retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform. However, a retraction must include any assurance demanded under Section 2-612.

(c) Retraction reinstates a repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay caused by the repudiation.

SOURCE: Sales, Section 2-611 (December, 1994)

Notes

1. There are no revisions in Section 2-614 (formerly Section 2-611).

2. **CISG.** There is no comparable provision in CISG. Under Articles 71 and 72, however, a party suspending performance for an apparent inability of the other to perform a substantial part of the contract, Article 71(3), or intending to declare the contract avoided for a repudiation, Article 72(2), must give immediate notice to the other. At that point, the other has the chance to provide adequate assurance of performance. Presumably that adequate assurance will include a retraction.

SECTION 2-615. CASUALTY TO IDENTIFIED PROPERTY. If the parties to a contract assume the continued existence and eventual delivery to the buyer of goods identified when the contract is made and the goods suffer casualty without the fault of either party before the risk of loss passes to the buyer, the following rules apply:

(1) The seller shall seasonably notify the buyer of the nature and extent of the loss.

(2) If the loss is total, the contract is avoided.

(3) If the loss is partial or the goods no longer conform to the contract, the buyer may nevertheless demand inspection and may treat the contract as avoided or accept the goods with due allowance from the contract price for the nonconformity but without further right against the seller.

Notes

1. The phrase “contract requires” in Section 2-613 of the 1990 Official Text has been replaced with the phrase “parties assume the continued existence of goods.” Section 2-615 provides a default rule and applies only if the parties have not otherwise agreed. Thus, if the contract does not require the tender of identified goods, evidence relevant to whether the parties assumed their continued existence should then be considered. For example, even if the contract does not expressly require the delivery of crops growing on the seller's land, a drought might still excuse the seller if both parties assumed the continued existence of those crops for performance. Support for this assumption might be derived from the capacity of the seller (i.e., a grower or a dealer), whether this farmer and others similarly situated historically have grown and sold only their own crops and any relevant prior course of dealing or usage of trade. The parol evidence rule, Section 2-202,

does not exclude evidence introduced to establish what both parties assumed would **not** happen.

2. The phrase “or in a proper case under a “no arrival, no sale” term, former Section 2-324” is deleted, pursuant to the Drafting Committee's decision to delete Sections 2-319 - 2-324 from revised Article 2.

3. The notice requirement in Section 2-615(1) was added to achieve parity with Section 2-618(b)(2).

4. Excuse for casualty to goods identified after contract formation is determined under Section 2-615.

5. **CISG.** Article 79(1) provides that a “party is not liable for a failure to perform any of his obligations if he proved that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences. Article 79(2) also provides limited excuse where a party's failure is “due to the failure by a third person. Arguably, this provision provides as much excuse from performance as does Section 2-612 (formerly Section 2-613).

SECTION 2-616. SUBSTITUTED PERFORMANCE.

(a) If, without fault of either party, agreed berthing, loading, or unloading facilities fail, an agreed type of carrier becomes unavailable, or an agreed manner of delivery otherwise becomes commercially impracticable, an aggrieved party may claim excuse under Section 2-617 unless a commercially reasonable substitute is available. In that case, the reasonable substitute performance must be tendered and accepted.

(b) If an agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery until the buyer provides a means or manner of payment that is commercially a substantial equivalent. If delivery has already been made, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive, or predatory.

SOURCE: Sales, Section 2-613 (December, 1994)

Notes

1. There are no revisions of substances in Section 2-616 (formerly Section 2-614).

2. **CISGA.** See Article 79(1).

SECTION 2-617. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Subject to Section 2-616 and subsection (b), delay in performance or nonperformance by either party is not a breach if performance as agreed has been made impracticable or a party's principal purpose is substantially frustrated by:

(1) the occurrence of a contingency whose nonoccurrence was a basic assumption on which the contract was made; or,

(2) compliance in good faith with any applicable foreign or domestic governmental regulation, statute, or order, whether or not it later proves to be invalid, which both parties assumed would not occur.

(b) A party claiming excuse under subsection (a) must seasonably notify the other party that there will be delay or nonperformance. If the claimed excuse affects only a part of the seller's capacity to perform, the seller must also allocate production and deliveries among its customers in any manner that is fair and reasonable and notify the buyer of the estimated quota made available. However, the seller may at its option include regular customers not then under contract as well as its own requirements for further manufacture.

SOURCE: Sales, Section 2-615 (December, 1994)

Notes

1. Subsection (a) now applies “unless otherwise agreed” rather than unless the parties have “assumed a greater obligation.” The parties, subject to the usual limitations, should be able to assume by agreement a greater or a lesser obligation than that provided in subsection (a).

2. Revised Section 2-617 now applies explicitly to the buyer's duty to accept and to pay for the goods as well as the seller's duty to transfer and delivery them. The rubric of “frustration of purpose” is used for buyer excuse. See

Restatement, Second, Contracts § 265. This revision is supported by Comment 9 to former Section 2-615 and the case law. The revision, however, does not change the standard for excuse or increase the rather slim odds that excuse will be granted in a particular case. Both parties must assume that the frustrating event will not occur. A buyer claiming excuse, however, must give the notice required under subsection (b) and comply with revised Section 2-618 (formerly Section 2-616).

3. The new Comments to Section 2-617 should summarize the interpretative case law under former Section 2-615. In sum, neither seller nor buyer can expect much sympathy when the claimed unexpected contingency was a shift in market conditions or an increase in the cost of performance. Even though performance as agreed under these conditions will be highly unprofitable, the courts tend to focus on the agreed price and quantity terms. Unless there is flexibility in those terms or other terms dealing with the changed circumstances, excuse will rarely be granted.

4. **CISG.** See Article 79(1), which grants excuse for an “impediment beyond his control and that he could not reasonably be expected to have taken ... into account at the time of the conclusion of the contract or to have avoided or overcome ... This language is consistent with the law interpreting Force Majeure clauses. “Impediment” suggests external interference with the capacity to perform rather than changes affecting the incentive to perform. Thus, an unexpected labor dispute may impede the buyer's duty to take delivery of the goods but a severe drop in market prices would not impede the buyer's duty to pay for goods taken.

SECTION 2-618. PROCEDURE ON NOTICE CLAIMING EXCUSE.

(a) A party who receives notification of a material or indefinite delay in performance or an allocation permitted under Section 2-615 or 2-617 may, by notification in a record as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract:

- (1) terminate and thereby discharge any unexecuted portion of the contract; or
- (2) modify the contract by agreeing to take the available allocation in substitution.

(b) If, after receipt of notification under Section 2-615 or 2-617, a party fails to terminate or modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

(c) This section may be varied by agreement to the extent that the parties have assumed a different obligation under the preceding section.

SOURCE: Sales, Section 2-616 (December, 1994)

Notes

1. Section 2-618 has been revised to provide for cases where the buyer notifies the seller of a material delay or non-performance in payment.

2. **CISG.** There is no comparable provision in CISG. Article 79(4), however, requires that the party who fails to perform “must give notice to the other party of the impediment and its effect on his ability to perform. The penalty for failure to notify is damages. Also, Article 79(3) provides that the excuse or exemption provided by Article 79(1) “has effect for the period during which the impediment exists. These requirements provide a framework within which the parties can negotiate over allocations and adjustments.

SECTION 2-619. PRESERVING EVIDENCE OF GOODS IN DISPUTE.

To further the adjustment of a claim or dispute, the following rules apply:

(1) Either party to a sale of goods, on reasonable notification to the other, has a right to inspect, test, and sample the goods for the purpose of ascertaining the facts and preserving evidence. This right includes goods that are in the possession or control of the other.

(2) Parties to a sale of goods may agree to an inspection or survey by a third party to determine the conformity or condition of the goods and may agree that the findings will be binding upon them in any later litigation or adjustment.

SOURCE: Sales, Section 2-514 (December, 1994)

PART 7

REMEDIES

[A. IN GENERAL]

SECTION 2-701. SUBJECT TO GENERAL LIMITATIONS. The remedies of the seller, the buyer, and other protected persons under this [article] and [subparts 7B and 7C] are subject to the general limitations and principles stated in [subpart 7A].

Notes

1. Section 2-701 states that remedies of the seller and buyer and other protected persons are subject to the general remedial policies expressed in subpart A of Part 7. Some of these policies were expressed in Section 2-701 of the May, 1994 Draft. Particular remedies for the seller are stated in subpart B and remedies for the buyer are stated in subpart C. This organization for remedies, which is new in the October, 1995 Draft, follows that in Article 2A, Part 5.

The Committee on Style strongly recommends that Section 2-701 be deleted as a superfluous “roadmap” and the sections be renumbered. This will be done in the next draft.

2. **CISG.** Revised Part 7 is consistent with the remedial structure in CISG. Chapter II states the obligations of the seller (Articles 30-44) and the remedies of the buyer upon breach of contract by the seller. Article 45. Buyer's remedies include the “rights” provided in Articles 46-52, which are unique to the buyer, and “damages” claimed under Articles 74-77, which are common to the buyer and the seller. Similarly, Chapter III states the obligations of the buyer (Articles 53-59) and the remedies of the seller upon breach by the buyer. Article 61. Seller's remedies include the “rights” provided in Articles 62-65, which are unique to the seller, and “damages” claimed under Articles 74-77, which are common to both parties. In general, the Convention prefers specific performance over damages and states applicable damage principles in general terms.

SECTION 2-702. BREACH; PROCEDURES. If a party is in breach of a contract, the party seeking enforcement:

(1) has the rights and remedies as provided in this [article] and, except as limited by this [part], as provided in the contract;

(2) may reduce its claim to judgment or otherwise enforce the contract by any available administrative or judicial procedure, or the like, and arbitration if agreed to by the parties; and

(3) may enforce the rights and remedies available to it under other law.

SOURCE: Licenses, Section 2-2501 (September, 1994); Section 2A-501

Notes

This section, which was Section 2-501 in the May, 1995 Draft, states the general remedial options available upon breach of contract. Breach and default are defined in Sections 2-601 and 2-602. Arbitration is available only if agreed to in writing by the parties. See Federal Arbitration Act, 9 U.S.C. § 2. Clearly, the parties can always agree to mediate or otherwise settle the dispute by agreement.

SECTION 2-703. REMEDIES IN GENERAL.

(a) The remedies provided in this [article] must be liberally administered with the purpose of placing the aggrieved party in as good a position as if the other party had fully performed.

(b) Except as otherwise provided in this [part], an aggrieved party may not recover that part of a loss resulting from a breach of contract that could have been avoided by reasonable measures under the circumstances. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(c) The rights and remedies provided in this [article] are cumulative, but a party may not recover more than once for the same injury. A court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a better position than if the other party had fully performed.

(d) This [article] does not impair a remedy for breach of any obligation or promise collateral or ancillary to a contract for sale.

SOURCE: Licenses, Section 2-2502 (September, 1994); Sales, Section 2-701 (December, 1994)

Notes

1. The remedial policies in Section 2-703 are derived from Section 2-502 of the May, 1995 Draft and Section 2-701 of the May, 1994 Draft. The breaches which trigger these remedies are defined in Sections 2-601 and 2-602.

2. Subsection (a) directs the courts to protect the so-called “expectation interest. This restates the principle in Section 1-106(1) without intending to escape the other limitations of that section, i.e., that punitive damages and consequential damages are not allowed unless permitted by Article 2 or another rule of law.

Other remedial interests, such as reliance and restitution, are protected under the general damage measure in Section 2-704.

3. Subsection (b) states a general mitigation of damages requirement and is consistent with CISG Article 77. It supplements the mitigation principles built into particular remedy sections of Part 7, see, e.g., Sections 2-706 and 2-717, and is broad enough to include conduct by one party that prevents the other from curing a nonconforming performance. However, a party who satisfies the mitigation requirements of a particular section, such as Section 2-706(a) on resale, or enforces an agreed remedy, such as liquidated damages, is not subject to subsection (d). This relationship is clarified in the text.

A failure to mitigate means only that the aggrieved party cannot recover the preventable loss resulting from a breach. In most cases, the burden of establishing a failure to mitigate damages is on the defendant.

4. Subsection (c) reiterates the policy favoring cumulation of remedies by the aggrieved party. Giving the aggrieved party a relatively free choice of remedies, despite possible inconsistency, is supported by variables at the time of the breach, such as the stage of performance, condition and location of the goods, market stability and availability, and the importance of protecting the value of the bargain as agreed at the time of contracting through price, quantity and duration terms.

Nevertheless, this choice of remedies must be made in good faith and be consistent with the general remedial policy of subsection (a). Accordingly, the court, if requested by the defendant, may deny a particular choice when that remedy under the circumstances puts the aggrieved party in a better position than full performance would have done. In most cases, this will occur when the aggrieved party's choice of damages based upon the difference between contract and market price exceeds the profits that would have been made by full performance. Subsection (c) also rejects the view that the exercise of one remedy, such as resale by the seller or “cover” by the buyer, automatically precludes a subsequent choice to pursue another remedy, such as market damages. Again, the question is whether the choice exceeds the expectation principle.

The limitation would not apply to enforceable agreed remedies, such as liquidated damages, or to remedies which seek to restore the plaintiff to the position occupied at the time of contracting or breach, such as restitution and reliance claims.

SECTION 2-704. DAMAGES IN GENERAL. To the extent that the remedies in this [part] fail to put the aggrieved party in as good a position as if the other party had fully performed, the aggrieved party may recover the loss resulting in the ordinary course from the breach as determined in any reasonable manner, together with incidental damages and consequential damages, less expenses and costs avoided as a result of the breach.

SOURCE: Sales, Section 2-701 (March, 1995)

Notes

1. This section, which is derived from Section 2-701 of the May, 1994 Draft, provides a general damage measurement to supplement more particular applications. It is comprehensive enough to protect all of the interests of an aggrieved party, especially where the expectation interest alone is inadequate. See *Bausch & Lomb, Inc. v. Bressler*, 977 F.2d 720 (2d Cir. 1992).

To illustrate, suppose the seller agrees to manufacture goods to meet the buyer's particular purposes. The seller repudiates and goes into bankruptcy. Section 2-704 applies if specific performance is not available, the buyer cannot find another seller willing to supply the goods and a market price for goods of that kind cannot be proved.

2. An aggrieved party who is unable to establish general or "direct" damages may still recover incidental and consequential damages as permitted under Sections 2-705 and 2-706.

SECTION 2-705. INCIDENTAL DAMAGES. Incidental damages resulting from breach of a contract include any commercially reasonable charges, expenses, or commissions incurred after the breach with respect to:

- (1) inspection, receipt, transportation, care, and custody of property after the other party's breach;
- (2) stopping delivery or shipment;
- (3) effecting cover, return, or resale of property; and
- (4) reasonable efforts otherwise to minimize or avoid the consequences of breach.

SOURCE: Sales, Sections 2-715, 2-710 (December, 1994)

Notes

1. Section 2-705 combines the incidental damages of seller and buyer into a single section. It replaces Sections 2-710 and 2-715(1) of the 1990 Official Text.

2. Incidental damages are reasonable expenses incurred after a breach to mitigate damages, perform duties with regard to the goods and to effect other remedies. They should be distinguished from consequential damages, which result from expenditures or commitments made before the breach to enable the aggrieved party to obtain and use the other party's performance. This distinction was observed in *Fertico Belgium S.A. v. Phosphate Chemicals Export Association, Inc.*, 510 N.E.2d 334 (N.Y. 1987), where the buyer recovered "incidental" damages for arranging a "cover" after the seller's delay in delivery and was entitled to consequential damages for additional costs incurred in getting the goods to resale buyer after the time for performance had passed.

SECTION 2-706. CONSEQUENTIAL DAMAGES. Consequential damages to a seller, buyer or other protected person for breach of contract include:

(1) losses resulting from a breach which the breaching party at the time of contracting had reason to know would probably result from the aggrieved party's general or particular requirements and needs, are not unreasonably disproportionate to the risk assumed by the breaching party under the contract, and the aggrieved or the breaching party could not avoid by reasonable measures under the circumstances; and

(2) subject to Section 2-319, injury to person or property proximately resulting from breach of warranty.

SOURCE: Sales, Sections 2-710(b), 2-715(b) (March, 1995)

Notes

As a result of considerable discussion of consequential damage during the drafting process, the following changes, reflected in Section 2-706, have been made.

1. **Seller's recovery.** Sellers may now recover consequential damages under the same standards applicable to buyers. The Drafting Committee rejected the interpretation that former Section 2-710, in combination with Section 1-106(1), denied consequential damages to sellers.

The following examples illustrate the application of Section 2-706 to sellers. Assume that the foreseeability and mitigation requirements have been satisfied.

(a) Seller makes a special expenditure in preparation to perform which will not be reimbursed by Buyer's full performance. After breach, Seller is unable to salvage the investment. The unreimbursed expenditure is recoverable as consequential damages.

(b) Seller has a profitable business opportunity the capture of which depends upon prompt payment by Buyer of the contract price. Buyer, who knew of the opportunity at the time of contracting and that substitute financing would be difficult, fails to pay and Seller is unable, after reasonable efforts, to obtain substitute financing. The lost profits, if proven with reasonable certainty, are recoverable as consequential damages. If Seller had been able to obtain a loan at 8% interest to capture the opportunity, the interest paid would be consequential rather than incidental damages. See Restatement, Second, Contracts § 351, Comment (e).

(c) Seller borrowed money at 8% interest to finance performance of the particular contract. The loan was to be repaid from the contract price. Buyer was late in payment and Seller could not obtain more favorable financing to pay off the loan. Consequential damages include the interest paid on the loan between the time when Buyer promised to pay the price and the time when it was paid. If, however, the loan was obtained to finance general business operations rather than a particular contract, the interest is fixed costs or overhead rather than consequential damages. See *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358 (7th Cir. 1985).

2. **“Unreasonably disproportionate.”** In addition to the usual limitations on the recovery of consequential damages, i.e., foreseeability, mitigation of damages, cause in fact, and proof with reasonable certainty, subsection (a) also excludes from consequential damages losses which are “unreasonably disproportionate to risks fairly assumed under the contract by the breaching party. This limitation, which the breaching party must prove, is derived from § 351 of the Restatement, Second, of Contracts.

After discussion at the January, 1996 meeting of the Drafting Committee, the limitation was placed in subsection (a) rather than in a separate subsection (b) to clarify that the test was to be applied by the finder of fact in the first instance rather than subsequently by a court in what looked like a remittitur. Thus, claimed consequential damages are either within the limitation or not under subsection (a) and there is no reason to give the court power to “limit damages by excluding or limiting recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise. Section 2-706(b) (January, 1996).

The background of the “unreasonably disproportionate” limitation should be clear, especially where the buyer is the plaintiff. Consequential damages result where the buyer is deprived of timely use of conforming goods because of repudiation, non-delivery or breach of warranty. They usually include lost business profits, but courts will occasionally award damages for loss of good will, unreimbursed reliance and various disruption losses caused to the buyer or third parties. The potential scope of consequential damages is influenced by the purpose for which the goods are purchased, the nature of the breach, and the type of loss caused. Where the purpose is to use the goods in a business or to resell them and breach is by non-delivery, the loss is profits (opportunity costs) that would have

been made if delivery were timely. See *Hydraform Products Corp. v. American Steel & Aluminum Corp.*, 498 A.2d 339 (N.H. 1985). Where the purpose is resale or the goods are intended as components for use in or with other goods sold to third parties and a breach of warranty occurs, (i.e., the goods are unmerchantable) more than the buyer's lost profits are involved. Third parties now have claims for breach of warranty against the buyer, including possible damage to person and property, which can be asserted cumulatively by the buyer against the seller as consequential damages for breach of warranty. Finally, the liability potential may be exacerbated if there is a product recall. Thus, the risk of uncertain and potentially heavy consequential damages is a matter of continuing concern to sellers. Although this limitation is intended to control this risk, its application should be limited to cases where there is an extreme disparity between the price charged by the seller and the foreseeable loss caused to the buyer (this suggests that the price was not intended to cover the risk) or there is an "informality of dealing, including the absence of a detailed written contract, which indicates that there was no careful attempt to allocate all of the risks. Restatement, Second, § 351, Comment (f).

3. Buyer's Recovery. Section 2-706(a)(1) a complex default rule which tends to favor the buyer but which is easy to limit or exclude by agreement. In the current jargon, it is a "penalty" default rule because the buyer is penalized (no recovery) if it fails to inform the seller of particular circumstances or losses of which the seller would otherwise have no reason to know. So if the foreseeability test is not satisfied or the contract contains an excluder clause, the risk of consequential losses is on the buyer.

Even without an excluder clause, the buyer must satisfy four conditions to recover under subsection (a)(1):

(a) The loss must result from (be caused by) the breach. This cause-in-fact requirement is common to all breach of contract claims, but may be more difficult to establish when the loss is remote from the breach.

(b) The loss must result from general or particular requirements of the buyer of which the seller had notice (knowledge or reason to know) at the time of contracting. This is Article 2's version of the famous principle in *Hadley v. Baxendale*. In addition, subsection (a)(1) now requires the breaching party to have reason to know at the time of contracting that the loss "would probably result from the breach. See Restatement, Second, Contracts § 351. This occupies the middle ground between losses that are "likely to result" and losses that are simply "in the cards," and is unlikely to change the operation of this section.

(c) An otherwise foreseeable loss is not recoverable if, after the breach, it could have been prevented by either the aggrieved or the breaching party through "reasonable measures under the circumstances. This limitation, which is a specific application of Section 2-703(b), works best where the buyer can cover to minimize or avoid lost profits.

Normally, the breaching party must establish that the plaintiff failed to mitigate. See Section 2-703(b). In cases where both parties could have avoided the loss by the same or similar acts and it is "equally reasonable" to expect the breaching party to minimize damages, the defendant is in no position to contend

that the plaintiff failed to mitigate. See, e.g., *Nezperce Storage Co. v. Zenner*, 670 P.2d 871 (Id. 1983).

(d) The plaintiff must prove the loss with reasonable certainty. This limitation controls loss in complex cases of remote or speculative damage, (e.g., loss of good will, new businesses) but is not an insuperable barrier in most cases.

4. The Drafting Committee rejected an alternative to subsection (a)(1), taken from Section 4A-305(d), which provided that between merchants, no consequential damages are recoverable unless they are expressly agreed to in a record.

This rejected alternative is a simple but extreme penalty default rule. Under it, the seller has no liability for consequential damages unless the buyer bargains for protection that is expressly agreed to. This default rule may work well in an Article 4A funds transfer, where the low cost of the transfer has no relationship to the dollar amount transferred or the risk that a payment order will be late, improperly executed or not executed at all and commercial parties with relatively equal bargaining power are involved. Given the varieties and complexities of contracts for the sale of goods, the appropriateness of the Article 4A model was doubted by the Drafting Committee.

4. Subsection (a)(2) still provides that consequential damages include “injury to person or property proximately resulting from breach of warranty. This subsection, however, is now subject to proposed Section 2-319(a), where property is defined to exclude damage to the goods sold.

5. **CISG.** There is no specific provision permitting the recovery of incidental damages, but both seller and buyer can recover foreseeable consequential damages. Article 74.

SECTION 2-707. SPECIFIC PERFORMANCE.

(a) A court may, at its discretion, decree specific performance if the parties have expressly agreed to that remedy or the goods or the agreed performance of the breaching party are unique or in other proper circumstances.

(b) A decree for specific performance may include terms and conditions as to payment of the price, damages, or other relief that court considers just.

(c) The buyer has a right to recover goods identified to a contract if, after reasonable efforts, the buyer is unable to effect cover for the goods or the circumstances indicate that an effort to obtain cover would be unavailing, or if the

goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

SOURCE: Licenses, Section 2-2506 (September, 1994); Section 2A-521; Sales, Section 2-716 (December, 1994)

Notes

1. There are two changes in subsection (a):

First, specific performance is not limited to the buyer [former Section 2-716(1) applied only to buyers]. A seller may obtain specific performance of the buyer's agreement to accept and to pay for the goods in appropriate cases. This simply affirms what some courts have always done, especially in long term supply contracts. Specific performance is an alternative to the seller's action for the price under Section 2-722. Unlike an action for the price, however, specific performance preserves the contract and acts *in personam* to enforce the agreement for future performance.

Second, the parties may expressly provide for the remedy of specific performance in the contract. The expectation is that a court will enforce the agreed remedy even though legal remedies at the time of the breach are entirely adequate. This expectation is consistent with a growing consensus that specific performance is, in most cases, a more efficient remedy than damages. See, e.g., Alan Schwartz, *The Myth That Promisees Prefer Supra Compensatory Remedies: An Analysis of Contracting For Damage Measures*, 100 Yale L. J. 369 (1990).

Note that subsection (a) gives the court discretion ("may ") to award specific performance if the parties have so agreed. Thus, the court might decline to make the award where the remedy is burdensome to administer. Further, the assumption is that a court will condition the specific performance decree upon full performance by the aggrieved party. Thus, a seller cannot obtain specific performance of the buyer's agreement to pay the price in the future unless the seller tenders goods that conform to the contract. See Section 2-722.

On the other hand, concern was expressed that under an agreed specific performance remedy a buyer, particularly a consumer buyer, could be forced to take and pay for goods that it did not need or want. This result is inconsistent with the policy expressed in Section 2-722(a)(3) that unless resale is not reasonably available the seller cannot recover the price of identified goods that the buyer has not accepted. In these cases, the court "may, at its discretion, deny the remedy.

2. **CISG.** Specific performance is the preferred remedy for sellers and buyers under the Convention. See Articles 46 and 62. See also, Steven Walt, *For Specific Performance Under the United Nations Sales Convention*, 26 Tex. Int'l L. J. 211 (1991). Article 28 provides, however, that if under CISG "one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgment for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.

SECTION 2-708. CANCELLATION; EFFECT.

(a) If a party breaches a contract, the aggrieved party may cancel the contract if the conditions of Section 2-715 or 2-723(a) are satisfied or if the agreement so provides.

(b) Cancellation is not effective until the canceling party sends notice of cancellation to the other party.

(c) Upon cancellation, each party is subject to the same obligations and duties with respect to goods in its possession or control as the party would be if it had rejected a nonconforming tender and remained in control of the goods of the other party or if the contract had terminated according to its own terms.

(d) Subject to subsection (e), upon cancellation, all obligations that are still executory on both sides are discharged.

(e) The following survive cancellation:

- (1) any right based on previous default;
- (2) any limitation on the scope, manner, method, or location of the exercise of rights in goods;
- (3) any limitation on disclosure of information;
- (4) any obligation to return goods, which obligation must be promptly performed; and
- (5) any remedy for default of the whole contract or any unperformed balance.

(f) Unless a contrary intention clearly appears, expressions of “cancellation, “rescission or “avoidance of the contract or similar terms may not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

SOURCE: Licenses, Section 2-2504 (September, 1994); Section 2A-505; Sales, Sections 2-106(3)(4), 2-720, 2-721 (December, 1994)

Notes

1. This section, which is new, is derived from several existing sources and presents a coherent approach to the self-help remedy of cancellation for breach by: (1) stating the grounds for cancellation; (2) requiring notice of cancellation; (3) stating the obligations and duties of the parties upon cancellation; (4) stating what obligations are discharged and what survive upon cancellation; and (5) preserving, in most cases, damage claims for antecedent breach. Further coordination is needed with other sections in this article, especially those dealing with rejection and cure.

2. A seller who cancels after a buyer's breach and has possession or control of goods identified to the contract is not in the same position as a buyer who rejects or revokes acceptance upon breach by the seller. In the latter case the buyer is a bailee of the seller's goods and is subject to the duties imposed by Section 2-605. In the former case the seller is not a bailee and may resell or keep the goods as permitted in Section 2-715.

3. **CISG.** CISG's equivalent to "cancellation" is "avoidance" for a fundamental breach of contract. See Articles 25, 49(1), and 64(1). The effects of a proper avoidance are stated in Articles 81-84. In general, it is more difficult to avoid the contract under CISG than it is to cancel under Article 2. Moreover, the seller's remedies of contract-market price damages or resale and the buyer's remedies of contract-market price damages and "cover" depend upon avoidance. Articles 75 and 76.

SECTION 2-709. CONTRACTUAL MODIFICATION OF REMEDY.

(a) Subject to Section 2-710, the following rules apply:

(1) An agreement may add to, limit, or substitute for the remedies provided in this [article], limit or alter the measure of damages recoverable for breach, or limit the buyer's remedies to return of the goods and repayment by the seller of the price or to repair and replacement of nonconforming goods or parts by the seller.

(2) An agreed remedy under paragraph (1) may not operate to deprive the aggrieved party of a minimum adequate remedy under the circumstances.

(3) Resort to an agreed remedy under paragraph (1) is optional, but if the parties expressly agree that the remedy is exclusive, it is the sole remedy.

(b) Subject to subsection (a)(2), if, because of a breach of contract or other circumstances, an exclusive, agreed remedy fails substantially to achieve the intended purposes of the parties, the following rules apply:

(1) In a contract other than a consumer contract, the aggrieved party may, to the extent of the failure, resort to remedies provided in this [article] but is bound by any other agreed remedy that is not dependent upon the failed remedy.

(2) In a consumer contract, an aggrieved party may reject the goods or revoke acceptance and, to the extent of the failure, have other remedies permitted in Section 2-723.

(c) Subject to subsection (b) and except for injury to the person, consequential and incidental damages and injury to property may be limited or excluded by agreement, unless the exclusion or limitation is unconscionable.

SOURCE: Sales, Section 2-719 (December, 1994) as modified during January, 1995 meeting; Licenses, Section 2-2503 (September, 1994)

Notes

1. Section 2-709(a) validates agreements modifying or limiting remedies. The unstated assumption is that such agreements must be conscionable at the time of contracting, Section 2-105, and not otherwise subject to the defenses of fraud, mistake or duress. See Section 1-103.

An unanswered question is how far such agreements may go in varying the standard remedies for breach of contract. At what point does an agreed remedy become a penalty (too much) or sink below some minimum adequate remedy (too little)? In commercial cases where exclusive, limited remedies have been agreed, the courts have given the parties wide latitude. See *Canal Electric Co. v. Westinghouse Electric Corp.*, 973 F.2d 391 (1st Cir. 1992), upholding an allocation of risk between “highly sophisticated business entities. On the other hand, the aggrieved party, despite the agreement, should be entitled at the very least to some minimum adequate remedy, presumably not less than restitution. See *McDermott, Inc. v. Iron*, 979 F.2d 1068 (5th Cir. 1992).

After discussion at the January and March, 1996 meetings, the Drafting Committee approved the language in Section 2-709(a)(2) as a limitation on the agreed remedies permitted in Section 2-709(a)(1). What is and what is not a minimum adequate remedy depends upon the circumstances of each case.

2. The “failure of essential purpose” problem in subsection (b) continues to plague the courts and challenge the commentators. In these cases, the seller, either directly or through a dealer, obtains an agreement with the buyer that may: (1) Make a limited express warranty, (2) Exclude or limit implied warranties, (3) Promise, on breach of express warranty, to repair, replace parts or otherwise cure the breach for a stated period of time, and (4) Exclude liability for consequential damages. These clauses, typically, are well drafted and are stated to be “exclusive. Problems start when a breach occurs and the seller is unable or unwilling to perform the limited, agreed remedy. Here there is one (the express warranty) and probably two (the agreement to “cure”) breaches by the seller. What are the buyer's remedies? Should they differ when the buyer is a consumer? Subsection (b) answers these questions.

Beyond a breach of contract, no attempt is made to define when “circumstances” cause a failure. Clearly, the inability of the seller after reasonable efforts to comply with the agreed remedy is a prime example. This may also be a second breach of contract for which independent remedies are available. See Sections 2-103(a)(3), 2-503, 2-504, and 2-704. Other “circumstances” are left to the courts. A failure, however, leaves the buyer facing a breach of warranty or breach of an agreement to repair by the seller and usually in possession of nonconforming goods.

Non-consumer contracts. Subsection (b)(1) provides a mainstream solution for non-consumer contracts. The starting point is clear: To the extent that the agreed remedy has failed the aggrieved party has the remedies provided by Article 2. In short, the “default” remedies fill the gap caused by failure. The court, therefore, must determine (1) the intended scope of the agreed remedy, (2) the extent to which the agreed remedy has failed, and (3) and the “default” remedies available to the aggrieved party. This may or may not include revocation of acceptance.

What about agreed remedies, such as limitations or exclusions of consequential damages, which are outside of and not dependent upon the failed agreed remedy? If a term excluding consequential damages is found to be independent of the failed remedy, enforceability depends upon whether it was unconscionable under Section 2-709(c). Stated another way, subsections (b) and (c) are independent of each other unless the excluder clause under subsection (c) depends upon a functioning agreed remedy under subsection (b). See *Colonial Life Insurance Co. of America v. Electronic Data Systems Corp.*, 817 F. Supp. 235 (D. N.H. 1993) (supporting this analysis). But see *International Financial Services, Inc. v. Franz*, 534 N.W.2d 261 (Minn. 1995), holding that the “excluder” clause is deemed to be independent in contracts between merchants even though it is lumped together with the failed agreed remedy.

Nevertheless, lingering problems not easily resolved in legislation remain. Suppose, for example, that the excluder term appears to be independent of the failed remedy and conscionable at the time of contracting but the seller committed fraud or acted in bad faith in dealing with the failed remedy package. Or suppose that after the agreed remedy failed, the buyer has no adequate remedy if the excluder term were enforced. These circumstances have prompted some courts to deny enforcement to the excluder clause, presumably because either the seller was in some way at fault or the buyer had no minimum adequate remedy, such as

restitution. This latter problem is addressed in subsection (a)(2), to which subsection (b) is subject. Issues of fraud and bad faith are left to the courts.

After the January, 1996 meeting, subparagraph (b) was redrafted to add that an aggrieved party is bound to an agreed remedy under subparagraph (a) that was not dependent upon and thus survives the failed agreed remedy. The effect of that surviving agreed remedy, however, will be tested under subparagraph (a)(2). To illustrate, suppose that an agreed repair-replacement remedy fails but a clause excluding consequential damages survives. This clause may first be tested for unconscionability under subparagraph (c). Even if the clause was conscionable at the time of contracting, it may be unenforceable if its effect is to deprive the aggrieved party of a minimum adequate remedy under subparagraph (a)(2). In commercial cases, however, neither of these outcomes is probable.

Consumer Contracts. Subsection (b)(2) [subsection (d) in the March, 1995 Draft], redrafted after the March, 1996 meeting of the Drafting Committee, provides a somewhat different remedy for consumers. At the January, 1996 meeting, a motion to delete subsection (d) was supported 21-5 by the observers but failed to pass (5-5) the Drafting Committee. At the March, 1995 meeting another motion to delete subsection (d) was made and rejected by both the observers and the Drafting Committee (0-7). After further discussion, a motion to approve the essence of revised subsection (b)(2) was passed by the Drafting Committee (8-2).

3. Subsection (c), which is also subject to subsection (a)(2), provides that except for injury to person, see Section 2-319(c), consequential or incidental damages can be limited or excluded by agreement unless the agreement is unconscionable. “Damage” includes economic loss and damage to the goods sold and “injury” includes other property owned by the buyer. See Section 2-319(a). The phrase permitting the exclusion of “incidental damages” was approved at the January, 1995 meeting of the Drafting Committee. Thus, in commercial cases the parties may agree that the aggrieved party assumes the risk of both losses resulting from investments made before the breach (consequential damages) and expenses incurred after the breach to mitigate loss (incidental damages). Such an agreement was enforced in *McNally Wellman Co. v. New York State Electric & Gas Corp.*, 63 F.3d 1188 (2d Cir. 1995) (New York law).

The January, 1996 Draft of subsection (c) provided that a conspicuous term in a record excluding consequential damages for commercial loss and injury to property is presumed to be conscionable. This provided a limited safe harbor against attack. That language was deleted by the Drafting Committee at the January, 1996 meeting. Further, the Drafting Committee deleted the phrase “where the loss is commercial, consequential injury to property” which was found at lines 20-21 of the January, 1996 Draft of subsection (c). The effect is that all agreements excluding or limiting consequential damage or injury to property in commercial cases are tested under subsection (c) and that there is no statutory “safe harbor.”

5. **CISG.** There is no comparable provision in the Convention. Is Section 2-709 is a rule of validity within Article 4(a)? If so, should Article 2 say so?

SECTION 2-710. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages for breach of contract may be liquidated but only at an amount that is reasonable in the light of the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach. A term liquidating damages in an unreasonably large or small amount is unenforceable. If a liquidated damage term is unenforceable under this subsection, the aggrieved party has the remedies provided in this [article].

(b) If a seller justifiably withholds or stops performance because of the buyer's breach of contract or insolvency, the buyer is entitled to restitution of the amount by which the sum of payments exceeds the amount to which the seller is entitled under terms liquidating damages in accordance with subsection (a).

(c) A buyer's right to restitution under subsection (b) is subject to offset to the extent that the seller establishes a right to recover damages under the provisions of this [article] other than subsection (a) and the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(d) If a buyer has received payment in goods, their reasonable value or the proceeds of their resale are payments for the purposes of subsection (b).

SOURCE: Sales, Section 2-718 (December, 1994)

Notes

1. Subsection (a) preserves former Section 2-718(1) with the following exceptions: First, the liquidation need only be reasonable in light of the difficulties in proof of loss, not also in light of the difficulties in obtaining a remedy; and Second, a term liquidating damages in an unreasonably large or **small** amount is unenforceable. Thus, a terms that at the time of contracting looks reasonable can be reviewed in light of actual damages caused by a breach. At the January, 1996 meeting, the Drafting Committee voted to delete a special rule for consumer contracts and to approve subsection (a) as drafted. A suggestion that a court should have power to fix damages if the liquidation clause was unenforceable was not acted on.

3. Section 2-710 deals with the liquidation of damages not the limitation of damages by agreement. The limitation agreements are covered by Section 2-709. To illustrate, suppose commercial parties negotiated a reasonable liquidated damage amount of \$5,000 under subsection (a) but the actual damages were \$100,000. This agreement may be enforceable as a reasonable liquidated damages,

even though damages were underliquidated. On the other hand, suppose, without any effort to liquidate, the parties agreed that under no circumstance will the seller's damages for breach exceed \$5,000. This is a limitation (an arbitrary fixing) rather than an attempt to fix a reasonable amount and its enforceability is governed by Section 2-709(c).

4. Subsections (b), (c), and (d) have been revised to clarify a breaching party's right to restitution after the aggrieved party's damages have been calculated and paid.

5. **CISG.** There is no provision dealing with liquidated damages in the Convention. Restitution claims are permitted in certain cases of avoidance for fundamental breach. See Articles 81(2), 82, and 84.

SECTION 2-711. REMEDIES FOR MISREPRESENTATION OR

FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this [article] for nonfraudulent breach. Rescission or a claim for rescission of a contract for sale and rejection or return of the goods do not bar, and are not inconsistent with, a claim for damages or other remedy.

SOURCE: Sales, Section 2-721 (December, 1994)

SECTION 2-712. PROOF OF MARKET PRICE.

(a) If evidence of a price prevailing at the times or places described in this [article] is not readily available, the following rules apply:

(1) The price prevailing within any reasonable time before or after the time described may be used.

(2) The price prevailing at any other place that in commercial judgment or usage of trade is a reasonable substitute may be used, making any proper allowance for the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant price prevailing at another time or place offered by one party is not admissible unless the party has given the other party notice that the court finds sufficient to prevent unfair surprise.

(b) If the prevailing price or value of goods regularly bought and sold in any established commodity market is in dispute, reports in official publications or trade journals or in newspapers, periodicals, or other means of communication in general circulation and published as the reports of that market are admissible in evidence. The circumstances of the preparation of such a report may affect the weight of the evidence but not its admissibility.

SOURCE: Sales, Sections 2-723, 2-724 (December, 1994)

Notes

1. Section 2-712 is an integration of former Sections 2-723 and 2-724, with one exception. Former Section 2-723(1), dealing with the time for measuring damages for repudiation when the case came to trial before the time for performance, has been deleted. This issue was covered in Sections 2-721 and 2-727 in the March, 1995 Draft. At the March, 1995 Meeting, the Drafting Committee rejected the theory underlying Sections 2-721 and 2-727 and directed a redraft.

2. **Historical Note:** The reasons for the proposed and now rejected revision are as follows. Original Section 2-723(1) dealt with the proof of market price when an action based on repudiation came to trial “before the time for performance with respect to some or all of the goods. In order to reduce uncertainty regarding proof of future prices (a sound objective), market price was determined at the time when the seller or buyer “learned of the repudiation. Original Section 2-723(1), however, created several dilemmas:

First, it appeared to be inconsistent with the provision for repudiation damages in Section 2-713(1) of the 1990 Official Text, which were measured at the time the buyer “learned of the breach. Similarly, it seemed to ignore Section 2-610(a) of the 1990 Official Text, which provided that an aggrieved party could wait for performance for a “commercially reasonable time after the repudiation.

Second, it stated that “any damages based on market price were subject to the “learned of the repudiation test, even though the time for delivery of some goods under the repudiated contract had passed at the time of trial. If the purpose of original Section 2-723(1) was to deal with uncertainty in the proof of future prices, the “any damages language made no sense at all.

Third, the original Section 2-723(1) did not clearly provide for the special problems of repudiated long-term contracts. For example, no distinction was drawn between goods sold on the “spot market and the market price of goods sold under long-term contracts and there was no explicit requirement that profits awarded for repudiation of long-term contracts be discounted to present value.

The solution to these problems starts with the policy judgment made by the Drafting Committee that if there is a breach by repudiation and there has been no

resale or cover, the aggrieved party's market damages under revised Sections 2-721(a) and 2-727(a) should be measured when a commercially reasonable time after the aggrieved party learns of the repudiation has expired. This avoids speculation by the aggrieved party in a changing market and ties the market price to the time when the aggrieved party "should have resold, covered or taken other action. For example, suppose the parties enter a 5 year contract, dated January 1, 1990, for the delivery of goods in installments at a contract price of \$100 per unit. On July 1, 1992, Seller writes a letter repudiating the contract which Buyer receives on July 5. Buyer has "learned of the repudiation on July 5 and, under revised Section 2-613, can, among other things, wait for performance for a "commercially reasonable time. Suppose that this time expires on August 1, 1992 without performance or retraction of the repudiation. Buyer takes no remedial action, i.e., no "cover, sues for damages under Section 2-727 and the case comes to trial on February 1, 1993. Under revised Section 2-727(a), August 1, 1992 is the time for measuring **all** of Buyer's market damages for Seller's repudiation, even though the time for performance between August 1, 1992 and February 1, 1993 has passed. This revision combines the policy judgment that Buyer should not be permitted to speculate on the market between August 1 and the agreed times for delivery and the policy judgment contained in former Section 2-723(a) that uncertainty in proving damages for repudiated future deliveries should be measured on (or shortly after) the aggrieved party learned of the repudiation.

3. **CISG.** Article 76 states the time when and place where the current price for damages is to be determined, but makes to provision for proof of market price.

SECTION 2-713. LIABILITY OF THIRD PARTIES FOR INJURY TO

GOODS. If a third party deals with goods identified to a contract for sale and causes actionable injury to the goods, the parties to that contract have the following rights and remedies:

(1) A party with title to or a security interest, special property interest, or insurable interest in the goods has a right of action against the third party.

(2) If the goods have been destroyed or converted, the party who had the risk of loss under the contract for sale or since the injury has assumed that risk as against the other also has a right of action against the third party.

(3) If at the time of the injury the plaintiff does not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, any recovery or settlement is subject to the plaintiff's interest as fiduciary for the other party to the contract.

(4) Either party, with the consent of the other, may maintain an action for the benefit of a concerned party.

SOURCE: Sales, Section 2-722 (December, 1994)

Notes

There are no changes of substance in former Section 2-722 of the 1990 Official Text.

SECTION 2-714. STATUTE OF LIMITATIONS.

(a) Except for actions subject to Sections 2-312(e) and 2-319(c), an action for breach of a contract for sale, including breach of an agreement under Sections 2-503 and 2-504, must be commenced within four years after the right of action has accrued. Except in a consumer contract, the parties in the original agreement may reduce the period of limitation to not less than one year but may not extend it.

(b) Except as otherwise provided in subsection (c), a right of action accrues when the breach occurs, even though the aggrieved party had no knowledge of the breach. For purposes of this section, a breach by repudiation occurs when the aggrieved party learns of the repudiation.

(c) If a breach of warranty occurs, the following rules apply:

(1) Subject to paragraph (2), a right of action accrues when the seller has tendered delivery of or has completed any agreement to assemble or install nonconforming goods, whichever is later.

(2) If a warranty expressly extends to performance of the goods after delivery, a right of action accrues thereafter when the buyer discovers or should have discovered the breach.

(3) If the seller, after delivery, attempts to conform goods to the contract and fails, the period of limitation is tolled for the time of the attempt.

(d) If an action commenced within the applicable time limitation is terminated but a remedy by another action for the same breach is available, the other action may be commenced after the expiration of the time limitation and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure to prosecute.

(e) This section does not alter the law on tolling of the statute of limitations and does not apply to a right of action that accrued before this [article] took effect.

SOURCE: Sales, Section 2-725 (December, 1994)

Notes

1. Subsection (a) retains the time of breach rather than the time of discovery rule for all but a breach of warranty claims. Thus, an action must commence within four years of the breach, unless the parties have agreed to a shorter time not less than one year. In repudiation cases, the right of action accrues when the aggrieved party learned of the repudiation even though damages may be measured at a later time.

At the January, 1996 meeting, the Drafting Committee rejected a motion to delete the second sentence in subsection (a) but agreed to add the phrase “except in consumer contracts. Thus, agreements in consumer contracts to reduce the four year period to not less than one year are unenforceable. A further motion to state that a commercial agreement to reduce the four year period must not operate in an “unconscionable manner” was rejected by the Drafting Committee.

2. For breach of warranty claims, two alternatives were proposed in the May, 1995 Draft. Alternative A preserved the “time of breach” rule and clarified when the limitation period is tolled. Alternative B, following Section 2A-506(2), adopted a “discovery” test for when the cause of action accrues and preserved the four year time limitation thereafter. The “discovery” test responds to the real risk that where certain types of manufactured goods are involved a buyer might not know or have reason to know of a breach of warranty until the limitation period has expired. The effect of this risk is exacerbated by the so-called “economic loss” rule, which prevents access to the “discovery” statute of limitations applicable to tort claims.

At the January, 1996 meeting the Drafting Committee adopted Alternative A in principle. The discussion, however, identified several problems that must be resolved:

First, Alternative A must be harmonized with other limitation periods in Article 2. See, for example, Sections 2-318 and 2-319. This assumes, of course, that the different periods are justified and operate in a fair manner. Whether this is so is a matter of debate.

Second, should a separate limitation period be adopted for warranty of title claims? The answer is yes. See Section 2-312. The risk is high that in sales of art work or antiques the limitation period will run before a “true” owner makes a claim to the goods. Since there is no longer a warranty of quiet possession, the buyer will have no claim against the seller.

Third, how can subsection (c)(1) state more clearly when a warranty expressly extends to performance after delivery?

Fourth, special attention should be paid to breaches of collateral contracts to install or maintain or to repair the goods or to replace non-conformity goods. When does the breach occur and when does the limitation period begin to run.

The July, 1996 Draft provides answers to each question.

3. **CISG.** The Convention has no statute of limitations. Parties must rely upon the Convention on the Limitation Period of the International Sale of Goods (1974), which the United States has now ratified.

[B. SELLER'S REMEDIES]

SECTION 2-715. SELLER'S REMEDIES IN GENERAL. If a buyer is in breach, the aggrieved seller, with respect to any goods directly affected and, if the breach is of the whole contract, Section 2-611, with respect to the undelivered balance may:

- (1) withhold delivery of the goods;
- (2) stop delivery of the goods by any carrier or bailee pursuant to Section 2-718(b);
- (3) proceed under Section 2-717 with respect to goods still unidentified to the contract;
- (4) obtain specific performance under Section 2-707 or recover the price as provided in Section 2-722;
- (5) resell and recover damages as provided in Section 2-719;
- (6) recover damages for repudiation or nonacceptance as provided in Section 2-721;

(7) recover incidental and consequential damages as provided in Sections 2-705 and 2-706; or

(8) cancel the contract.

SOURCE: Sales, Section 2-703 (January, 1995)

Notes

1. Subject to the general policies in Part 7, subpart A, this section catalogues the seller's remedial options that are triggered by the breaches defined in Sections 2-601 and 2-602. Although not all remedies are available in every case, they are stated cumulatively. Remedial choices are limited by Section 2-703(c).

Breach by wrongful rejection or wrongful revocation of acceptance are, in fact, breaches by non-acceptance. See Section 2-721. Breach by failure to make a payment due includes failures to pay before, at or after delivery, and may or may not entitle the seller to the price under Section 2-722.

Whether the seller can resort to remedies under this section for repudiation, depends initially upon Section 2-613: The seller may not resort to Section 2-715 unless the buyer "repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other. Thus, a partial repudiation of an installment that does not substantially impair the value of the whole contract would not be actionable. It would, however, justify a demand for adequate assurance of due performance.

2. Relationship to Article 9. Several of the catalogued remedies for breach are "self-help" remedies. Depending on the nature of the breach, the seller can withhold delivery, stop delivery by a carrier or bailee, identify goods to the contract or salvage unfinished goods, resell the goods or cancel the contract without judicial intervention. So long as the seller has possession or control of the goods the remedies are effective against the buyer.

What about purchasers from or creditors of the buyer. Can they take an interest superior to the seller? Until the buyer has possession or control of the goods, the answer is no. This is consistent with Section 9-113, which treated some of these remedies as security interests arising under Article 9, and the fact that what ever interest to buyer has in the goods before delivery is subject to the seller's right to withhold delivery. Although the Article 2 and Article 9 Drafting Committees agree on what the answer should be, a clear statement in the relevant sections must still be made.

These remedies are supplemented by the power to suspend performance after a demand for adequate assurance, Section 2-612 or where the buyer is insolvent. Section 2-718(a). The exercise of self-help remedies may fully protect the seller, lead to an agreed settlement of the dispute or simply be a prelude to litigation. The unjustified exercise of a self-help remedy is a breach by the seller.

3. The seller's judicial remedies include specific performance, Section 2-707, an action for the price, Section 2-722, damages based upon the difference

between the contract and market price, Section 2-721(a), and damages measured by lost profits, 2-721(b). Claims for incidental damages are made under Section 2-705 and claims for consequential damages, to which the seller is now entitled, are made under Sections 2-705 and 2-706.

4. **CISG.** Article 61(1) provides a general guide to the articles dealing with the seller's rights and damages on breach by the buyer. Article 61(2) states that the seller is “not deprived of any right he may have to claim damages by exercising his right to other remedies.

SECTION 2-716. SELLER'S RIGHT TO RECLAIM GOODS AFTER DELIVERY TO BUYER.

(a) Under this [article], a seller may reclaim goods delivered to a buyer under a contract for sale only in the following circumstances:

(1) A seller who discovers that the buyer has received goods on credit while insolvent may reclaim the goods upon a demand made within 10 days after receipt. If a misrepresentation of solvency was made in a record to the reclaiming seller less than three months before delivery, the demand is timely if made within a reasonable time after delivery.

(2) If payment is due and demanded on delivery to the buyer, a seller may reclaim the goods delivered upon a demand made within a reasonable time after the seller discovers or should have discovered that payment was not made.

(b) Reclamation is subject to the rights under this [article] of a buyer in ordinary course of business or other good-faith purchaser for new value that arise before the seller takes possession under a timely demand for reclamation. Successful reclamation of the goods excludes all other remedies with respect to them.

SOURCE: Sales, Section 2-702 (January, 1995)

Notes

1. Revised Section 2-716 combines in one section the two historical grounds for seller reclamation, insolvency in a credit sale and the so-called “cash sale” doctrine. These grounds, which are exclusive for Article 2, are in addition to

the repossession right given to a secured party under Section 9-503. See also, Section 2A-525. They are, however, limited to the goods and do not extend to the proceeds of the goods. But see *United States v. Westside Bank*, 732 F.2d 1258 (5th Cir. 1984) (proceeds within scope of reclamation). Moreover, since public notice of the reclamation right has not been given, it is a mistake to treat this historical Article 2 lien as if it were a non-possessory security interest. Reclamation here is exceptional and limited.

2. Subsection (a) states the grounds for reclamation and fixes a time within which the reclamation must be made that fits the particular case. These grounds are in the nature of a lien, but since possession has been transferred to the buyer, they do not constitute a security interest arising under Article 2. See Section 9-113.

Subsection (a)(2) does not apply where, after delivery in a “cash sale, the buyer discovers a nonconformity in the goods and stops payment of the check.

At the January, 1995 meeting of the Drafting Committee it was suggested that subsection (b)(2) be amended to add the phrase “but not less than 10 days after the phrase “within a reasonable time. No action was taken.

3. Subsection (b) determines the priority between the rights of reclaiming seller and the rights of a “buyer in the ordinary course or other good faith purchaser under Section 2-403. At the March 18, 1994 meeting of the Drafting Committee, it was argued that subsection (b) gave inadequate protection to the reclaiming seller. Motions were made to delete secured parties from the list of creditors with potential priority over the seller and to expand the seller's protection to proceeds. The votes were inconclusive, so no change was made in the draft. See *In re Blinn Wholesale Drug Co., Inc.*, 164 B.R. 440 (E.D.N.Y. 1994) (“good faith purchaser includes secured party with after acquired security interest). At the March, 1996 meeting of the Drafting Committee, a decision to require “new value before a good faith purchaser (with a perfected security interest) takes priority over the reclaiming seller was made.

The provision in the 1990 Official Text of Section 2-702 that a successful reclamation by the seller “excludes all other remedies with respect to the goods was, after a vote of the Drafting Committee, deleted in the May, 1994 Draft. The issue rose again at the January, 1995 meeting of the Drafting Committee, where it was argued that the deletion was improper and would change the law. This concern was also expressed at the December, 1995 meeting of the Reporter with the Article 9 Drafting Committee. Thus, the phrase was reinstated, subject to further discussion.

Finally, after considerable discussion, a decision not to grant the reclaiming seller the remedy of “self help was made at the March, 1996 meeting of the Drafting Committee.

4. Assuming that grounds for reclamation exist, consider the following cases.

Case #1. Seller makes a timely demand and takes possession from the buyer before any rights of buyers or purchasers arise. Seller clearly wins.

Case #2. Seller makes a timely demand after the rights of buyers or purchases arise and they have taken possession of the goods. This is easy. Buyer or purchaser wins.

Case #3. Seller makes a timely demand after the rights of buyers or purchases arise but before they take possession. Seller then takes possession. If a first to possess test applies, Seller, as the first to take possession, wins. If a “right to possession test applies, the purchasers should win, even if that right is conditional or possession has not been transferred.

As a policy matter, a “right to possession test should apply and that right arises when the competing party becomes a buyer in the ordinary course of business or a good faith purchaser.

Case #4. Consider the following variations on Case #3.

(a) A buyer otherwise in the ordinary course of business has a special property interest in identified goods but has not taken possession when the seller's timely reclamation demand is received.

(b) A good faith buyer for value has either a special property interest or title in the goods but has not taken possession when the seller's timely reclamation demand is received.

(c) A secured party (a good faith purchaser) who has given new value has an enforceable security interest in the buyer's after-acquired property which attaches to the goods but the secured party has not repossessed them before the reclamation demand is made.

Seller should lose in each case. The status of the purchasers is clear and the right to possession has arisen, even though still conditional. The seller, on the other hand, has given up possession without public notice of its Article 2 reclamation right and has not regained possession before the rights of the others arises. To win, the seller must both give timely notice of reclamation and retake possession from the buyer before the right to possession of good faith buyers and purchasers arises.

5. A reclamation right under Section 2-702 may or may not be enforceable against a trustee in bankruptcy under revised Section 546(c) of the Bankruptcy Act. No attempt has been made to conform revised Section 2-702 to the requirements of Section 546(c). See, e.g., *In re Julien Co.*, 44 F.3d 426 (6th Cir. 1995) (no reclamation under § 546(c) where buyer not insolvent and demand not in writing).

6. Former Section 2-702(1) of the 1990 Official Text now appears in revised Section 2-718(a).

7. **CISG.** Under the Convention, a seller who avoids a contract for fundamental breach can reclaim delivered goods from the buyer. Although goods delivered either for cash or on credit can be reclaimed, there are no express limitations on the time or method of reclamation. See Articles 64(1), 81(2), and 84(2).

SECTION 2-717. SELLER'S RIGHT TO IDENTIFY GOODS TO CONTRACT NOTWITHSTANDING BREACH OR TO SALVAGE UNFINISHED GOODS.

(a) An aggrieved seller may:

(1) identify to the contract conforming goods not already identified if they are in the seller's possession or control at the time the seller learned of the breach; and

(2) resell goods that are shown to have been intended for the particular contract, even if they are unfinished.

(b) If goods are unfinished at the time of breach, an aggrieved seller, in the exercise of reasonable commercial judgment to minimize loss and for the purpose of effective realization, may complete the manufacture and wholly identify the goods to the contract, cease manufacture and resell for scrap or salvage value, or proceed in any other reasonable manner.

SOURCE: Sales, Section 2-704 (January, 1995)

Notes

1. No changes of substance have been made in former Section 2-704 of the 1990 Official Text.

2. Section 2-717 gives an aggrieved seller several choices if goods are conforming but not identified or identified but unfinished at the time of breach.

Subsection (a)(1) permits the seller to identify conforming goods to the contract, Section 2-402, and pursue appropriate remedies. Subsection (a)(2) permits the seller to resell identified but unfinished goods, a remedy that already exists under Section 2-719(b). Neither option explicitly requires the exercise of "reasonable commercial judgment" but both are subject to the general mitigation requirement in Section 2-703.

Subsection (b) assumes that goods to be manufactured by the seller are unfinished at the time of breach and gives the seller a choice to either complete the manufacturing process (and resell) or stop manufacturing and salvage. The choice must be made in the exercise of "reasonable commercial judgment." To illustrate, suppose the contract price is \$1,000 and the buyer repudiates when the manufacturing process is 50% completed. It would cost \$600 to finish the goods and the resale price of the completed goods is estimated to be \$100. On the other

hand, if the seller stopped manufacturing and salvaged, the estimated damages under Section 2-721(b) would be \$400. All things being equal, Section 2-717(b) requires the seller to stop and salvage. The post-breach decision to invest \$600 to realize \$100 on resale of the completed goods, or the full contract price if resale is not possible, enhances the seller's damages and is not commercially reasonable.

3. **CISG.** The Convention does not have a comparable provision.

SECTION 2-718. SELLER'S REFUSAL TO DELIVER BECAUSE OF BUYER'S INSOLVENCY; STOPPAGE IN TRANSIT OR OTHERWISE.

(a) A seller who discovers that the buyer is insolvent may refuse delivery except for cash, including payment for all goods previously delivered under the contract.

(b) Subject to subsection (d), a seller may stop delivery of goods in the possession of a carrier or other bailee if the buyer is insolvent or repudiates or fails to make a payment due before delivery or if, for any other reason, the seller has a right to withhold or reclaim the goods.

(c) As against a buyer under subsection (b), the seller may stop delivery until:

(1) receipt of the goods by the buyer;

(2) acknowledgment to the buyer by any bailee of the goods other than a carrier or by a carrier by reshipment or as warehouseman, that the bailee holds the goods for the buyer; or

(3) negotiation to the buyer of any negotiable document of title covering the goods.

(d) If notice to stop delivery has been given, the following rules apply:

(1) The notice must afford the carrier or bailee a reasonable opportunity to prevent delivery of the goods.

(2) After notification, the carrier or bailee must hold and deliver the goods according to the directions of the seller. However, the seller is liable to the bailee for any resulting charges or damages.

(3) If a negotiable document of title has been issued for goods, the carrier or bailee need not obey a notification to stop until surrender of the document.

(4) A carrier or bailee that has issued a nonnegotiable document need not obey a notification to stop received from a person other than the person named in the document as the person from whom the goods have been received for shipment or storage.

SOURCE: Sales, Section 2-705 (January, 1995)

Notes

1. There are two revisions of substance in Section 2-718.

First, the power of a seller to refuse delivery to an insolvent buyer except for cash, previously stated in former Section 2-702(1) of the 1990 Official Text, is now expressed in Section 2-718(a).

Second, the limitation that the shipment must be at least a “carload, truckload or planeload” before a seller can stop delivery in transit for breach by the buyer is deleted. The seller may now stop delivery of any shipment where the buyer is insolvent or has breached the contract. There is no requirement that the buyer's breach be substantial.

The Drafting Committee concluded that the “carload, truckload or planeload” limitation was unrealistic in light of changing shipping methods and practices. For example, why should a seller not be able to stop delivery of a packet of goods shipped by, say, Federal Express, upon breach by the buyer, especially since the location of the goods can quickly be determined by computer? In most cases, the carrier or bailee's interest is protected by subsection (d)(1), which provides that the carrier must, after receiving notice from the seller, have a “reasonable opportunity to prevent delivery.” This flexible standard takes into account the type of goods, their location and the carrier's ability to find them and promptly stop delivery at the time notice is received.

2. The seller's power under subsection (b) to stop delivery is limited by subsection (c). In short, the stop delivery notice is too late if any of the events listed has occurred. Other conditions upon the power to stop are stated in subsection (d). Thus, the seller may have effectively stopped delivery against the

buyer under subsection (c) but failed to satisfy the conditions of subsection (d), which protect the interest of the carrier or bailee.

Note that creditors of or purchasers from the buyer are subject to the seller's right to stop under this section. See *In re Morrison Industries, L.P.*, 175 B.R. 5 (W.D.N.Y. 1994) (right to stop effective against buyer in bankruptcy).

3. **CISG.** Article 71(1) states when a party may suspend performance of obligations and Article 71(2) carries that right over to cases where the goods have been “dispatched. These provisions have little detail. Article 71(3), however, requires the party suspending performance to give immediate notice of suspension to the other and to continue performance if the other provides adequate assurance of his performance. These latter requirements are not found in Article 2.

SECTION 2-719. SELLER'S RESALE.

(a) If a buyer has breached a contract and the goods concerned are in the seller's possession or control, the seller may resell them or the undelivered balance. If the resale is made in good faith, within a commercially reasonable time, and in a commercially reasonable manner, the seller may recover the contract price less the resale price together with any consequential or incidental damages, less expenses avoided as a result of the buyer's breach.

(b) A resale:

(1) may be at a public or private sale including sale by one or more contracts to sell or by identification to an existing contract of the seller;

(2) may be as a unit or in parcels and at any time and place and on any terms, but every aspect of the sale, including the method, manner, time, place, and terms, must be commercially reasonable; and

(3) must be reasonably identified as referring to the breached contract, but the goods need not be in existence or have been identified to the contract before the breach.

(c) If the resale is at a public auction, the following rules apply:

(1) Only identified goods may be sold unless there is a recognized market for the public sale of futures in goods of the kind.

(2) The resale must be made at a usual place or market for public sale if one is reasonably available. Except in the case of goods that are perishable or which threaten to decline in value speedily, the seller shall give the buyer reasonable notice of the time and place of the resale.

(3) If the goods are not to be within the view of persons attending the sale, the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders.

(4) The seller may buy the goods.

(d) A good-faith purchaser at a resale takes the goods free of any rights of the original buyer, even if the seller fails to comply with this section.

(e) A seller is not accountable to the buyer for any profit made on a resale. However, a person in the position of a seller or a buyer who has rightfully rejected or justifiably revoked acceptance shall account for any excess over the amount of the security interest provided in Section 2-723(c).

SOURCE: Sales, Section 2-706 (January, 1995)

Notes

1. The phrase “public auction” in subsection (c) replaces “public sale” in the 1990 Official Text and defines the type of sale to which those conditions apply. The consensus was that for all practical purposes a public sale and a public auction were one and the same.

2. At the January, 1995 meeting, the Drafting Committee reaffirmed the earlier decision to delete Section 2-706(3) of the 1990 Official Text, which required the seller to give the buyer reasonable notification of its intention to resell at a private sale. Previously, notice was treated as a condition precedent to a proper resale just as it was required in a disposition by public or private sale to enforce a security interest under Section 9-504(3). Since a seller in possession may have a security interest arising under Article 2, Section 9-113, and the resale remedy is similar to the rights of a secured party, Section 9-113, Comment 1, a common notice requirement seemed to make sense, especially when the interest of the buyer or debtor was considered.

The Drafting Committee, however, decided to limit the notice requirement to sales made to enforce a security interest created by agreement or clearly imposed by statute. See Section 2-723(c). Notice in the latter cases is more important because the debtor has an interest in the goods sold and owes a fixed amount of

money. In the typical resale under Section 2-719, the buyer is normally not a debtor and has no interest in the goods. In the view of the Drafting Committee, therefore, the deletion of former subsection (3) is not likely to harm the buyer and would avoid undermining an otherwise commercially reasonable resale and creating uncertainty about follow up remedies if the resale were not proper. In short, if the resale is in good faith and is commercially reasonable under subsection (a), the seller is entitled to resale damages even though the buyer was not notified.

3. The relationship between Sections 2-719 and 2-721 is important. Consider these variations where the goods are in fact resold:

(a) **Resale in good faith and in a commercially manner.** Section 2-719(a) is probably the preferred remedy. Section 2-721(b), however, is available in a lost volume situation. Section 2-721(a) might be available, but only if those damages do not put the seller in a better position than if the buyer had fully performed. See Section 2-703(c). Thus, the fact that the seller has complied with Section 2-719(a) should not automatically foreclose the choice of market damages under Section 2-721(a). The question is, considering the resale, whether that choice puts the seller in a better position than full performance would have.

(b) **Resale in good faith but not in a commercially reasonable manner.** Although Section 2-719(a) is not available, Section 2-721(a) may be used and, in a case of lost volume, damages under Section 2-721(b) are available.

(c) **Resale in bad faith.** Damages under Section 2-721(a) are available only if they are the substantial equivalent of damages that would have been available if the seller complied with Section 2-719(a).

4. If an action for the price is not available, Section 2-722(a), the seller may prefer to resell the “goods concerned or the undelivered balance. The buyer, of course, must be in breach and the resale process is subject to the general remedial policies in Chapter 1, Part 5 as well as the particular requirements of Section 2-719. The goods “concerned” can include those which at the time of the breach are: (1) existing and identified; (2) existing and not identified but identified thereafter; (3) unfinished but finished and identified thereafter, Section 2-717(b); and (4) not existing and not completed until after the resale contract. See subsection (3)(b).

5. **CISG.** Article 75 permits the seller to resell the goods after the contract has been avoided for fundamental breach, but contains none of the detail in Section 2-719. If the seller resells, damages are measured by the “difference between the contract price and the price in the substitute transaction. Furthermore, if the seller resells, damages measured by the difference between the contract price and the market price are not available. Article 76.

SECTION 2-720. PERSON IN POSITION OF SELLER.

(a) A person in the position of a seller includes, as against a principal, an agent who has paid or become responsible for the price of goods on behalf of the

principal or any person who otherwise holds a security interest or other right in goods similar to that of a seller.

(b) A person in the position of a seller has the same remedies as a seller under this [article].

SOURCE: Sales, Section 2-707 (January, 1995)

Notes

There are no changes in former Section 2-707 of the 1990 Official Text.

SECTION 2-721. SELLER'S DAMAGES FOR NONACCEPTANCE, FAILURE TO PAY, OR REPUDIATION.

(a) Subject to Section 2-712, if the buyer breaches a contract, the seller may recover damages based upon market price as follows:

(1) If the case comes to trial after the agreed time for performance, the measure of damages is the contract price less the market price of comparable goods at the time and place for tender, together with any incidental and consequential damages, less expenses avoided as a result of the buyer's breach.

(2) If the case comes to trial before the agreed time for performance, the measure of damages is the contract price less the market price of comparable goods at the place for tender at the time when a commercially reasonable period after the seller learned of the repudiation has expired, together with any incidental and consequential damages, less expenses avoided as a result of the buyer's breach.

(b) A seller may recover damages measured by other than the market price including:

(1) lost profits, including reasonable overhead, resulting from the breach determined in any reasonable manner, together with incidental and consequential damages; and

(2) reasonable expenditures made in preparing for or performing the contract if, after the breach, the seller is unable to obtain reimbursement by salvage, resale, or other reasonable measures.

SOURCE: Sales, Section 2-708 (January, 1995)

Notes

Revised Section 2-721 makes several important changes.

1. Subsection (a), which measures damages based upon market price, is subject to Section 2-703. Thus, a seller cannot choose subsection (a) if market damages (objective) puts it in a better position than full performance by the buyer would have done (subjective). To illustrate, suppose the seller resells identified goods under Section 2-719(a) at or above the contract price or actually recovers the price under Section 2-722. Section 2-721(a) is not available because any recovery would put the seller in a better position than full performance would have done. Similarly, if the difference between the contract price and the resale price under Section 2-719(a) was \$1,000 and the difference between the contract price and the market price under Section 2-721(a) was \$1,200, the \$1,000 amount will control. Finally, if damages under Section 2-721(a) exceed the profits that the seller would have made by full performance under subsection (b), subsection (b) controls.

Note that the seller's choice of Section 2-721(a) controls unless the buyer proves from actual figures that the market price recovery puts the seller in a better position than full performance. Hypothetical figures will not do. In all probability, market damages should be limited to the case where the seller has identified goods on hand and does not resell them. Here market damages serve as a surrogate for resale damages.

2. The measure of damages in subsection (a)(1) applies when the case comes to trial **after** the agreed time for performance of all or part of the contract has passed. Proof of contract price and market price prevailing at those times will be simplified. See *Trans World Metals, Inc. v. Southwire Co.*, 769 F.2d 902 (2d Cir. 1985). Note that the text awards damages based upon the “contract price **less** the market price of comparable goods. The “difference between language in the 1990 Official Text has been deleted. Also, damages are measured by the full contract price not the “unpaid contract price. Whether a breaching buyer can recover all or part of any contract price paid to the seller is determined under Section 2-710(b). Finally, the phrase “comparable goods includes both the goods themselves and the type of contract under which they are sold. Thus, the market price for the same type of goods sold on the “spot market and those sold under a long-term contract would not be comparable. See *Manchester Pipeline Co. v. Peoples Natural Gas Co.*, 862 F.2d 1439 (10th Cir. 1988).

Subsection (a)(1) applies in a case of breach by repudiation even though the seller waits until the agreed time for performance has passed before taking action. Undue speculation by the seller in a changing market is controlled by the mitigation policy in Section 2-703(b) and the duty to enforce the contract in good faith.

3. Subsection (a)(2) applies when the case comes to trial before the agreed time for performance. This will be a long-term supply contract, where some of the performance comes due before and some of the performance comes due after the case comes to trial. Here the primary concern is the uncertain proof of future market prices and, when the contract contains various escalation provisions, future contract prices.

The time for measuring the market price is when a commercially reasonable time after the seller learned of the repudiation has expired. See Section 2-613, which permits an aggrieved party to “await performance by the repudiating party for a commercially reasonable time. The judgment is that this is a reasonable time to forecast what future market prices will be for goods of that kind and that the seller should not be permitted to speculate on uncertain markets after that period – the time when the seller should have resold or otherwise mitigated damages – has expired. This is somewhat different from Section 2-723(1) of the 1990 Official Text, which measured damages for the unperformed balance at the time when the seller “learned of the repudiation. See *Roye Realty Co. v. Arkla*, 863 P.2d 1150 (Okla. 1993).

The “contract price” is not tied to when a commercially reasonable time after the seller learned of the repudiation has expired. Unless the contract price is fixed by agreement, the parties should have the benefit of any escalation or flexibility to which they have agreed.

4. At the March, 1994 and January, 1995 meetings of the Drafting Committee, a number of concerns were voiced about the subsection (a) as it appeared in the May, 1995 Draft. At the March, 1996 meeting of the Drafting Committee, the current subsection (a) was adopted. As a result:

(a) The so-called “snap shot” approach has been rejected in cases that come to trial before the agreed time for performance. The time for determining the contract price is not the same as the time for measuring market price.

(b) In cases that come to trial after the agreed time for performance, the uncertainty of when a commercially reasonable time has expired and whether the buyer actually repudiated has been eliminated. What the seller does or does not do does not turn on whether the buyer repudiated or not.

(c) In any case, there was a consensus among the Drafting Committee that any recovery for future profits should be reduced to present value. See Section 2A-102(1)(u).

(d) Other concerns about measuring damages for breach of a long-term supply contract remain. For example, suppose there is no market for goods sold under long-term contracts at the relevant time. Should the court then use a “spot market” price and, if so, wouldn't that price tend to over or undercompensate?

5. Subsection (b) measures damages by profits that would have been made upon full performance rather than the market price. It is a subjective test.

First, the seller's choice of subsection (b) is limited by Section 2-703(c), not the nature of the buyer's breach. Thus, the seller can choose subsection (b) where

the buyer breaches unless the buyer establishes that the choice puts the seller in a better position than full performance. This will be highly unlikely in three cases: (1) The seller does not have completed goods on hand; (2) Upon repudiation, the seller stops work and salvages under Section 2-717(b); and (3) The seller is a “lost volume” seller.

The buyer may require a seller who has selected subsection (a) to use subsection (b) when the contract price less market price exceeds the profits that would have been made by full performance. As a practical matter, this will be limited to a seller, such as a jobber or middleman, who does not have completed goods on hand but has hedged bets by making forward contracts for them. The cases have concluded that a seller who does not take the risk of market fluctuations is overcompensated when market damages under subsection (a) exceed the profits that would have been made under subsection (b). See, e.g., *Nobs Chemical, U.S.A., Inc. v. Koppers Co., Inc.*, 616 F.2d 212 (5th Cir. 1980); *Union Carbide Corp. v. Consumers Power Co.*, 636 F. Supp. 1498 (E.D. Mich. 1986).

Second, damages under subsection (b) include lost profits and, in appropriate cases, unreimbursed reasonable expenditures in preparation or part performance.

In most cases, lost profits, including reasonable overhead, are determined by subtracting the seller's total variable cost to perform, whether actual or estimated, from the contract price. The result should adequately compensate most lost volume sellers and sellers who have no completed goods on hand.

A seller who stops work and salvages under Section 2-717(b), may have both lost profits and unreimbursed reliance expenditures. Subsection (b)(2) allows recovery of those expenditures as well, provided that the seller has made reasonable efforts to mitigate losses. Thus, in this case, the amount needed to put the seller in as good a position as full performance includes both lost net profits, reasonable overhead and unreimbursed reliance.

Third, no effort is made to state when a seller has lost volume because of the buyer's breach or to provide a measurement standard for that complex situation. Recovery for lost volume, however, is still possible under the flexible standards of subsection (b). As before, the problems of definition and measurement are left to the courts. See *R.E. Davis Chemical Corp. v. Disonics, Inc.*, 826 F.2d 678 (7th Cir. 1987), on appeal from remand, 924 F.2d 709 (7th Cir. 1991).

SECTION 2-722. ACTION FOR PRICE.

(a) If a buyer fails to pay the price as it becomes due, the seller may recover, together with any incidental and consequential damages, the price of:

(1) goods accepted;

(2) conforming goods lost or damaged after risk of their loss has passed to the buyer, but if the seller has retained or regained control of the goods, the loss

or damage must occur within a commercially reasonable time after the risk of loss has passed to the buyer; and

(3) goods identified to the contract, if the seller is unable after a reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that this effort would be unavailing.

(b) A seller who remains in control of the goods and sues for the price shall hold any goods identified to the contract for the buyer. If the seller is entitled to the price and resale becomes possible, the seller may resell the goods at any time before the collection of the judgment. The net proceeds of the resale must be credited to the buyer. Payment of the judgment entitles the buyer to any goods not resold.

(c) If a buyer has committed a breach by failing to make a payment when due, a seller who has sued for and is held not entitled to the price under this section may still be awarded damages for nonacceptance under Section 2-721.

SOURCE: Sales, Section 2-709 (January, 1995)

Notes

1. No revisions of substance have been made in Section 2-722(a), which states the limited and exclusive conditions for recovering the price. Subsection (a)(2) has been revised to clarify that the commercially reasonable time limitation applies only where the seller has retained or regained possession of the goods.

It is assumed that the price may be recovered where the buyer accepts the goods and then makes a wrongful revocation of acceptance under Section 2-609.

2. Note that former Section 2-710 of the 1990 Official Text, which was revised in the May, 1994 Draft to include consequential damages for the seller, now appears as Sections 2-705 and 2-706.

3. The seller may now claim specific performance under Section 2-707(a). If justified by the agreement or the circumstances, the buyer may be ordered to accept and pay for the goods in exchange for the seller's conforming performance. Are there circumstances where this would be improper? For example, suppose the agreement for specific performance is in a standard form? Presumably, Section 2-206 deals with this problem. Or, suppose that there is an agreement for specific performance and the goods could easily be resold to a third person. Arguably specific performance is inefficient in this situation and the court could be persuaded to exercise its discretion and not enforce the agreement.

4. **CISG.** Under Article 62, the seller may “require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with this requirement. There are no conditions, such as those found in Section 2-722, and there is no specific provision permitting recovery of the price.

[C. BUYER'S REMEDIES]

SECTION 2-723. BUYER'S REMEDIES IN GENERAL; BUYER'S SECURITY INTEREST IN REJECTED GOODS.

(a) If a seller breaches a contract, the buyer, with respect to any goods involved and if the breach is of the whole contract, Section 2-611, with respect to the undelivered balance, may:

- (1) recover the price paid;
- (2) cancel the contract;
- (3) cover and obtain damages as to all the goods affected, whether or not they have been identified to the contract, as provided in Section 2-725;
- (4) recover damages for nondelivery or repudiation as provided in Section 2-726; and
- (5) if an acceptance of goods has not been justifiably revoked, recover damages for breach with regard to accepted goods under Section 2-727.

(b) If a seller fails to deliver or repudiates, the buyer may also:

- (1) recover identified goods under Section 2-724; or
- (2) in a proper case, obtain specific performance or replevy the goods under Section 2-707.

(c) On rightful rejection or justifiable revocation of acceptance, a buyer has a security interest in goods in the buyer's possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care, and custody. Subject to Sections 2-605 and 2-606, the

buyer may hold the goods and resell them as an aggrieved seller under Section 2-719. The buyer shall give the seller reasonable notification of the intended resale.

SOURCE: Sales, Section 2-711 (January, 1995)

Notes

1. Minor revisions were made in Section 2-723, which now conforms in style to Section 2-715 and is subject to Subpart A of Part 7.

2. The catalogue of available buyer remedies in subsection (a) has been expanded to include damages with regard to accepted goods, Section 2-727. Those remedies, although available under the 1990 Official Text, were not flagged in Section 2-711. Incidental and consequential damages are also recoverable under Sections 2-705 and 2-706. These remedies are in addition to the goods oriented remedies provided in subsection (b). Selecting a remedy from the catalogue, however, does not guarantee its applicability. A selected remedy is available “as provided” in the appropriate section and the choice is limited by Section 2-703.

3. Revised Section 2-723(c) creates a statutory security interest on behalf of the buyer in limited circumstances and for a limited amount. See Section 9-113. In a short compass, the subsection deals with when the security interest arises, what it secures, how long it lasts, the tension between the buyer's rights as a secured party and its duties as a bailee, and the right of resale. Compare Section 9-504. Note that the buyer resells under Section 2-719(e) to protect a security interest in goods in which the seller has the ownership interest. The buyer must account to the seller for any excess over the claims secured and must give reasonable notice of the intended resale to the seller.

SECTION 2-724. PREPAYING BUYER'S RIGHT TO GOODS. A buyer who pays all or a part of the price of goods identified to the contract, whether or not they have been shipped, on making and keeping good a tender of full performance, has a right to recover them from the seller if the seller repudiates or fails to deliver as required by the contract.

SOURCE: Sales, Section 2-502 (December, 1994)

Notes

1. The scope of former Section 2-502 has been expanded. Previously, a pre-paying buyer could recover identified, conforming goods only from a seller who became insolvent within 10 days after receipt of the first payment. Under revised Section 2-724, a pre-paying buyer can recover identified goods, whether or not conforming, from a seller, whether or not insolvent, who repudiates or fails to delivery “upon making and keeping a tender of full performance.

2. Revision history. Both the PEB Study Group and the ABA Task Force favored the repeal of former Section 2-502 on the grounds that tying the buyer's right to the goods to the seller's insolvency created an unacceptable risk of invalidation in bankruptcy. See 16 Del. J. of Corp. Law 981 at 1128-1129. If Section 2-502 were repealed, however, a pre-paying or financing buyer would have no right to the goods under Article 2 unless a right to specific performance or replevin under Section 2-707 were established. See Section 2-405(a). Beyond that, protection would depend upon compliance with Article 9.

The Drafting Committee concluded, however, that pre-paying buyers, especially consumer buyers, should have some protection under Article 2. An early revision of Section 2-502 broadened protection by substituting “repudiation or fails to deliver” for “insolvency” as the trigger for recovery and eliminating the 10 day time limitation. It also deleted Section 2-502(2) of the 1990 Official Text and limited the scope of buyer's right to “conforming, identified goods, regardless of which party identified them. See Section 2A-522(2), in accord. Under this version, therefore, identified but nonconforming goods were not covered by Section 2-502.

At the January, 1994 meeting, the Drafting Committee expanded the scope of Section 2-502 by eliminating the requirement that the identified goods be conforming and conditioning the right to recover upon tender by the buyer of “full performance” rather than tender of any “unpaid portion of the price. The result is a specific performance remedy for the pre-paying buyer that parallels that in Section 2-707.

3. Effect. Under revised Section 2-502, now Section 2-724, the buyer's right to the goods is effective against the seller and “creditors of the seller” under Section 2-405(a). Thus, unless the retention is fraudulent under Section 2-405(b) or the identification is a preference under Section 2-405(c)(2), the buyer is entitled to possession over an unsecured creditor, a lien creditor or a secured creditor of the seller. This is true whether the lien creditor's or secured party's interest attached before or after the contract was made. The implication is that the buyer takes free of creditor claims to the goods and that creditor interests attach to the proceeds of the sale, i.e., the buyer's tender of “full performance.

Without more, this implication is correct only if the buyer is a buyer in the ordinary course of business who takes free of a security interest under either Section 9-307(1) or Section 2-404(c). In other cases, the buyer may have a right to possession of but no priority of interests in the goods. In these cases, the buyer, after tendering full performance, should arrange a subordination agreement with the creditors before paying the price due.

Exactly when the buyer becomes a buyer in the ordinary course of business must still be resolved. For purposes of Section 2-724, at least, if the seller is in possession of identified goods and all other conditions are satisfied, the buyer should become a buyer in the ordinary course of business when the seller repudiates or fails to deliver. At that point the buyer has a right to possession. This proposed solution must be coordinated with Revised Article 9.

5. The difference between a pre-paying and a financing buyer is that the former usually pays part of the price before receiving goods that are identified and conforming to the contract and the latter pays to finance the manufacture or

processing of goods that are likely to be unfinished at the time of identification. Revised Section 2-724, by applying to both situations, suggests that in some cases the buyer must tender the full contract price to recover identified but unfinished goods. The extent to which a pre-paying or financing buyer can perfect a security interest in non-conforming goods in process is determined under Article 9. See Report, PEB Study Group, Uniform Commercial Code, Article 9 194-198 (1992).

Section 2A-522(1), with minor modifications, follows Section 2-502 of the 1990 Official Text. Section 2A-522(2), however, provides that identified goods must conform to the contract before the lessee can recover them. This limits the scope of the lessee's right to recover, but avoids the problem of what is a proper payment when the goods are identified but unfinished.

6. **CISGA.** CISGA has no provision dealing with a buyer's right to goods on the seller's insolvency and, in general, does not deal with the claims of the seller's creditors to those goods. But see Articles 41-43. Article 46(1), however, states that the "buyer may require performance by the seller of his obligations without regard to whether the buyer has prepaid the price. Revised Section 2-724 is now closer to Article 46(1) in granting the buyer what amounts to specific performance. See CISG Article 28, which states that a court is not "bound to specifically enforce a contract under CISG "unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.

SECTION 2-725. "COVER"; BUYER'S PURCHASE OF SUBSTITUTE GOODS.

(a) If a seller breaches a contract, the buyer may cover by making in good faith and without unreasonable delay any reasonable purchase of, contract to purchase, or arrangement to procure comparable goods to substitute for those due from the seller.

(b) A buyer who covers under subsection (a) may recover damages measured by the cost of covering less the contract price, together with any incidental or consequential damages, less expenses avoided as a result of the seller's breach.

(c) A buyer who does not cover or who fails in good faith to effect a cover that satisfies subsection (a) is not barred from any other available remedy.

SOURCE: Sales, Section 2-712 (January, 1995)

Notes

1. There are no changes of substance in former Section 2-712 of the 1990 Official Text.

2. If, after a breach, specific performance is not available and the buyer still needs the goods, “cover” is the preferred remedy. Subsection (a) authorizes “cover” and promotes flexibility in the sources and nature of that action. Thus, a buyer may cover in good faith by making the goods itself, purchasing from the breaching party or purchasing from third parties if those transactions are reasonable. Similarly what is “reasonable” may vary with whether the aggrieved party is a commercial or a consumer buyer. Finally, the phrase “comparable goods” suggests that the goods obtained by “cover” need not conform exactly to those promised under the breached contract.

3. Subsection (b) conditions the “cover” measure of damages upon satisfying subsection (a). “Cover” damages would not be available if the buyer acted in bad faith, delayed unreasonably or made an unreasonable purchase or arrangement. Presumably, the burden is on the buyer to prove that it is entitled to damages under subsection (b).

4. Subsection (c) states that a buyer who either fails to cover at all or covers in good faith but fails to satisfy the other conditions in subsection (a) is not barred from “any other remedy.” Similarly, a buyer who “covers” and satisfies subsection (a) is not automatically barred from any other remedy. In either case, the buyer may sue for market damages under Section 2-721(a), subject to the buyer's proof that market damages will put the buyer in a “better” position than full performance by the seller. Section 2-703(c).

As in Section 2-719, a buyer who covers in bad faith may be limited to the damages that would have been recovered by a good faith cover under Section 2-725(b). See Section 2-703(c).

5. **CISG.** Under Article 75, if the contract is avoided and the buyer has “bought goods in replacement,” damages are measured by the “difference between the contract price and the price in the substitute transaction” as well as any further damages under Article 74. If the buyer has made a purchase under Article 75, damages under Article 76 are not available.

SECTION 2-726. BUYER'S DAMAGES FOR NONDELIVERY OR REPUDIATION.

(a) Subject to Section 2-712, if a seller breaches a contract, the buyer may recover damages based on market price as follows:

(1) If the case comes to trial after the agreed time for performance, the following rules apply:

(i) If the breach is other than by repudiation the measure of damages is the market price for comparable goods at the time the buyer learned of the breach less the contract price, together with any incidental and consequential damages, but less expenses avoided in consequence of the seller's breach.

(ii) If the breach is by repudiation, subsection (a)(1)(i) applies, except that market price is determined at the agreed time for performance.

(2) If the case comes to trial before the agreed time for performance, the measure of damages is the market price of comparable goods at the time when a commercially reasonable period after the buyer learned of the repudiation has expired less the contract price, together with any incidental and consequential damages, but less expenses avoided in consequence of the seller's breach.

(b) Market price is determined at the place for tender. However, in cases of rejection after arrival or revocation of acceptance, it is determined at the place of arrival.

SOURCE: Sales, Section 2-713 (January, 1995)

Notes

1. Section 2-726, like Section 2-721 for the seller, is the buyer's "fall back remedy. It is a surrogate for "cover, in that damages are measured by the difference between the contract price and the market price of comparable goods at a time when "cover could have or should have been made. Like Section 2-721(a), choice by the buyer of Section 2-726(a) is limited by the remedial policy in Section 2-703(c): It must not put the buyer in a better position than full performance would have. See *Allied Cannery & Packers, Inc. v. Victor Packing Co.*, 209 Cal.Rptr. 60 (Cal.App. 1984) (where seller's failure to deliver partially justified by unexpected bad weather court limited the buyer to the profit it would have made upon a foreseeable resale rather than permit the buyer to recover damages under Section 2-713(1) [now Section 2-726(a)(1)].) *Allied Cannery* was distinguished in *KGM Harvesting Co. v. Fresh Network*, 42 Cal.Rptr. 2d 286, 26 UCC Rep.Serv.2d 1028 (Cal.App. 1995) and the analysis was rejected in *Tongish v. Thomas*, 840 P.2d 471 (Kan. 1992) (specific terms of Section 2-713(1) of the 1990 Official Text control general remedial limitations in Section 1-106(1)).

2. Subsection (a)(1) follows the approach to damages taken in Section 2-721(a)(1) where the case comes to trial after the agreed time for performance. The objective is to tie the market price to the agreed time for performance unless the buyer did not learn of the breach until after that date. Thus, if the seller failed to

ship as agreed on October 1 but the buyer did not learn of that failure until October 4, market price is determined on October 4. On the other hand, if the seller repudiated on September 15 and the buyer did not cover or take other remedial action, market price is determined on October 1 rather than the date the buyer learned of the repudiation. Subsection (a)(1)(ii). The buyer's duty to enforce the contract in good faith and to take reasonable measures to avoid loss control the buyer's discretion to speculate on a rising market.

(3) Subsection (a)(2) follows Section 2-721(a)(2) when the case comes to trial before the agreed time for performance. The time for measuring market price is when a "commercially reasonable time after the buyer learned of the repudiation has expired. See Section 2-613. Thus, market price is measured at the time when the buyer should have covered. See *Cosden Oil v. Karl O. Helm Aktiengesellschaft*, 736 F.2d 1064, *rehearing denied*, 750 F.2d 69 (5th Cir. 1984). Under this approach, whether the buyer had a valid reason for not covering is irrelevant. See also, *Trinidad Bean & Elevator Co. v. Frosh*, 494 N.W.2d 347 (Neb.App. 1992), holding that the time for determining market price is the time the buyer learned of the repudiation if it was commercially reasonable to cover on that date. For further discussion, see the Notes to Sections 2-711 and 2-721.

3. **CISG.** Under Article 76, if the contract has been avoided and there has been no "purchase" under Article 75, the buyer may recover the difference between the contract price and "current price at the time of avoidance as well as any further damages recoverable under article 74.

SECTION 2-727. BUYER'S DAMAGES FOR BREACH REGARDING ACCEPTED GOODS.

(a) A buyer who has accepted goods and given notice pursuant to Section 2-608(c)(1) may recover as damages for any nonconforming tender the loss resulting in the ordinary course of events from the seller's breach as determined in any reasonable manner.

(b) A measure of damages for breach of a warranty of quality is the value of the goods as warranted less the value of the goods accepted at the time and place of acceptance, unless special circumstances show proximate damages of a different amount.

(c) A buyer may also recover incidental and consequential damages.

SOURCE: Sales, Section 2-714 (January, 1995)

Notes

1. There are no changes of substance in subsections (a) and (c) of former Section 2-714 of the 1990 Official Text. Subsection (b), however, is stated as “a measure of damages rather than “the measure of damages and is limited to breaches of a warranty of quality. Thus, damages for breach of a warranty of title are measured under subsection (a) rather than subsection (b).

2. Section 2-714 applies when the buyer has accepted the goods, Section 2-607, and has not justifiably revoked acceptance under Section 2-609. Subsection (a) states the general damage rule, see Section 2-704, and subsection (b) states one measure of damages for breach of a warranty of quality, unless “special circumstances justify a different amount. Subsection (c) states simply that incidental and consequential damages under Sections 2-705 and 2-706 are recoverable in addition to damages under Section 2-727.

3. Subsection (b) has been frequently litigated, with sometimes puzzling results. The key measure for breach of a warranty of quality, i.e., Sections 2-313, 2-314, and 2-315, is the difference between the market value (not the contract price, although that may be prima facie evidence of market value) of the goods as warranted and the market value of the goods delivered at the time of acceptance rather than the time of tender. Damages have been determined in at least three ways: (a) If the goods are non-conforming but usable without repairs, the court simply determines the relevant differences in the market value at the time of acceptance; (b) If the goods are not usable without repairs, the court determines the market value as delivered plus the reasonable cost of repairs, which constitutes the market value of the goods as warranted; (c) If the goods are not usable under any circumstances, the court determines the difference in market value of the goods as scrap and the cost to purchase (market value) goods as warranted. See *Schroeder v. Barth, Inc.*, 969 F.2d 421 (7th Cir. 1992).

4. It is not always clear what “special circumstances show damages of a different amount and what the different amount should be. For example: (1) Suppose a seller warrants to a farmer that seeds are X when in fact they are Y, but the contract excludes liability for consequential damages. As a result of the breach of warranty, the farmer loses the crop because Y won't grow on the land. The market value of X and Y at the time of acceptance are the same. Some courts have found “special circumstances on these facts and awarded the farmer the value of the lost crop. The lost crop, however, is really consequential damages liability for which was excluded by the contract. (2) Suppose that the seller warranted that a specific computer system would satisfy the buyer's particular purposes. The specific system, however, failed to meet those purposes and another, more expensive system was required. Again, special circumstances suggest that damages should be measured by the difference in the market value of the system delivered and the market value of a hypothetical or replacement system that would satisfy the particular purposes rather than the specific system promised. See *Hospital Computer Systems, Inc. v. Staten Island Hospital*, 788 F. Supp. 1351 (D. N.J. 1992). (3) Another category where special circumstances frequently exist is damages for breach of warranty of title. See *First Valley Leasing, Inc. v. Goushy*, 795 F.2d 693 (D. N.J. 1992). These damages are now to be measured under subsection (a).

5. **CISG.** Under the Convention, a buyer has more power to “require the seller to perform and the seller has more power to “cure non-conformities than

under Article 2. After delivery where the seller has failed to cure, however, Article 50 provides that if the goods “do not conform with the contract and whether or not the price has already been paid, the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of delivery bears to the value that conforming goods would have had at that time. Thus, Article 50 combines the measurement standard in Section 2-727(b) with the buyer's power to reduce the price granted in Section 2-728.

SECTION 2-728. DEDUCTION OF DAMAGES FROM PRICE. A buyer, on so notifying a seller, may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

Source: Sales, Section 2-717 (December, 1984)

Notes

There are no changes of substance in former Section 2-717 of the 1990 Official Text. Compare CISG Article 50.