

January 1, 1997

To: The Article 2 Drafting Committee
From: Richard E. Speidel, Reporter
Re: Status of Article 2 revision

Here is a review of the January, 1997 Draft of Article 2. This overview highlights the important changes made at the November 15, 1996 meeting of the Drafting Committee, which are incorporated in the January, 1997 Draft.. Comments and recommendations of the Council of the ALI at their December, 1996 meeting are also noted.

I have focused on the more important issues to be discussed. More background on each section is provided in the Notes..

Part 1. General Provisions

Section 2-101. Short Title

Section 2-102. Definitions

(a)(1). The 2B definition of "authenticate" replaces "signed."

(a)(7). Conspicuous. The last sentence in the July, 1996 definition was deleted.

See Notes. This definition illustrates the occasional tension between the drafts of Articles 2 and 2B. The issues were discussed with the ALI Sales Consultative Group, with emphasis on whether conspicuous should be decided by a court rather than a jury (Article 1 and 2B so provide) and whether a clearer "safeharbor" should be provided. Ultimately, this definition should be in Article 1.

(a)(8). Consumer contract. A definition of consumer has been added.

(a)(17). A definition of "foreign exchange contract" is provided.

(a)(19). Good faith. This definition follows 3-103(a)(4) and was approved at the 1996 annual meeting of the Conference.

(a)(20). Goods. Obligations created by "foreign exchange contracts" are not goods and are excluded from Article 2 in 2-103(d).

[Section 2-103. Manifesting Assent; Opportunity to Review.]

This section was deleted at the November, 1996 meeting of the Drafting Committee. For the reason why, see the discussion after Section 2-206, **infra**.

Section 2-103. Scope.

At the November, 1996 meeting, the Drafting Committee deleted subsection (a) and replaced it with the familiar language in current Article 2: "Unless the context otherwise

provides, this Article applies to transactions in goods.

The scope issues previously included in sub. (a)(1) and (a) (2) are left to judicial development.

The service agreement defined in sub. (a)(3) was also excluded from Article 2. Thus, 2-602, which provided more detail on performance and enforcement of these contracts, is also deleted. In essence, the concern was that issues unique to service contracts might be included in Article 2 without adequate study.

The recent changes reflect a judgment that these transactions, particularly service agreements, should not be covered by a code, even though a sale of goods is involved. A court, however, may still apply Article 2 by analogy.

Section 2-104. Transactions Subject to Other Law.

Although 2-105(a)(1) states that Article 2 is subject to applicable certificate of title statutes, some argue that Article 2 takes precedence over conflicting state CTAs. Potential conflicts arise over when title passes, 2-501(b)(4), the power to transfer good title, 2-504, and the rights of seller's creditors against goods retained after sale, 2-505. This issue will be resolved at the next meeting of the Drafting Committee.

Section 2-105. Unconscionable Conduct, Contract or Clause.

The Annual Meeting rejected a motion to delete the "induced by unconscionable conduct" clause by a 84-38 vote. There was no motion to limit the clause to consumer contracts. Nevertheless, criticism of this phrase continues. What does it mean? Should it be limited to consumer contracts? Should it be there are all? These questions were raised by the ALI Sales Consultative Group.

A motion to delete the phrase "court finds as a matter of law" was also defeated. The jury does not get these cases. The question of allocation between judge and jury continues to spark controversy. For example, in Article 1 whether a record is conspicuous is for the court but in Article 2, 2-102(a)(7), the question is for the jury. How should that line be drawn.

Section 2-106. Interests and Part Interests in Goods.

Section 2-107. Goods to be Severed from Realty

A number of questions came up in reading this section at the 1996 Annual Meeting. See the Notes for discussion and resolution.

Section 2-108. Effect of Agreement.

Subsection (c) is former 2-107 of the July, 1996 Draft.

Part 2. Formation, Terms, and Readjustment of Contracts.

Section 2-201. No Formal Requirements.

The 1997 Annual Meeting (faced with a unanimous Drafting Committee) again rejected a

motion to restore the statute of frauds. The vote was 65-52.

However, the Drafting Committee, in November, 1996, agreed that some version of current 2-201 should be restored and a draft section has now been prepared.

Why this reversal? Assuming that one concludes that a statute of frauds is not needed in sales contracts to weed out perjured claims (and that use of the defense often promotes fraud), several reasons are given to retain the statute: (1) Article 2 should be consistent with 2A and 2B, which have statutes of frauds; (2) The presence of the statute tends to channel behavior toward reducing agreements to writing; and (3) The statute of frauds defense is a proxy for resolving contract formation issues on a summary judgment motion. The inconsistency with CISGA is, apparently, not persuasive.

Section 2-202. Final Written Expression; Parol or Extrinsic Evidence.

Subsection (b), which has been approved by the Drafting Committee, continues to spark debate. See Notes to January, 1997 Draft.

Should b(1), which reflects sound judicial practice, be in the Code? According to consumer interests, the answer is yes because many trial courts do not follow sound judicial practice. Those courts, contrary to Wigmore, Llewellyn, Corbin and Traynor, resolve the intention question from the plain meaning of language within the four corners of the record.

Should b(2) say anything about merger clauses, particularly in commercial transactions? It was contended at the ALI Sales Consultative Group meeting that a merger clause in a commercial contract should, subject to the usual defenses of fraud, mistake and unconscionability, be conclusive on the intention question. On the other hand, many courts still conduct a hearing to be sure. A compromise solution may be to delete (b)(2) and let the courts do their thing.

Section 2-203. Formation in General.

Formation questions arise in structured and unstructured deals and may or may not involved records, standard forms or standard terms. In the November, 1996 Draft, 2-203 and 2-205 are designed to deal with all formation questions, including contracts covered by 2-206 where all or part of the terms of the agreement are contained in a standard form (the offer) to which the adhering party manifests assent (the acceptance). See 2-203(a).

At the November, 1996 meeting, the Drafting Committee voted to delete 2-206(a), dealing with assent to standard forms, and except for consumer contracts, 2-206(b), eliminated the distinction between record and standard form which was built into the July, 1996 Draft.

The practical effect of this decision is that the word "record" must be substituted for "standard form" and the word "term" must be substituted for "standard term" in 2-203, 2-204, 2-205 and 2-207. Although these deleted terms reflect real world situations, they are excluded from Article 2.

The policy implications are that in commercial cases, including those involving small businesses, the question whether a party has agreed to terms in a standard form is determined under the usual standards of agreement or assent. The requirement of an "opportunity to review," contained in the definition of "manifest assent" in deleted 2-103 no longer applies. To put the matter differently, although the commercial world is full of standard forms and standard

terms [as defined in 2-102(a)], revised Article 2 provides no special rules to deal with them in commercial contracts. The risk of unfair surprise and unreasonably favorable terms is left to the unconscionability doctrine, 2-106.

Thus, 2-203 should be revised to substitute “record” for standard form in sub. (b) and (c).
See Note 4 for an alternative approach.

2-204. Firm Offers.

The last sentence should be revised as follows: “A term of assurance in a record supplied by the offeree is ineffective unless the term is conspicuous.”

2-205. Offer and Acceptance in Formation of Contract.

In subsection (a)(1), replace “standard form” with “record.”

In subsection (a)(2), the phrase “conforming or nonconforming” has been deleted from before the word “goods.” Thus, the offer is construed as inviting acceptance by either a promise to ship or by shipment and the assumption is that the promise or shipment will conform to the offer. What happens if the offeree ships non-conforming goods? Without more, this is a counteroffer. But the “however” sentence suggests that a shipment of nonconforming goods is an acceptance unless the shipment is an accommodation. Does this make sense?

Subsection (b) provides that if you accept by commencing performance and don't notify the offeror within a reasonable time, the offer is treated as “having lapsed before acceptance. Shouldn't we say that the offeror's contractual duty is “discharged”? See Restatement (Second) Contracts sec. 54(2).

2-206. Standard Form Records.

Subsection (a) was deleted at the November, 1996 meeting of the Drafting Committee, along with the concept of “manifest assent” in 2-103. Thus, a commercial party who signs or otherwise assents to a standard form or a record containing standard terms is bound unless the contract or terms are unconscionable under 2-106.

Note that the current draft of Article 2B develops special rules for assent to standard form contracts and for the so-called “mass market” transactions. The concept of “manifests assent” is crucial to these rules. **Some members of the ALI Council suggested that a “mass market” concept be developed for Article 2.**

Consumer contracts.

(1) Section 2-206(b) of the November, 1996 Draft provided a special rule for consumer contracts: If a consumer manifested assent [2-103] to a standard form and there was a term in the standard form which the consumer “could not reasonably have expected”, the term was not part of the contract unless the consumer “expressly” agreed to it. This higher requirement of assent [than that in former 2-206(b)] raised two important questions: (1) When is a term not reasonably expected; and (2) When is there express agreement?

2-206. Consumer Contracts.

At the November, 1996 meeting of the Drafting Committee, the essence of 2-206(b) was preserved with elaboration in a new Section 2-206 dealing with standard forms in consumer contracts. A first draft of that section appears in the January, 1997 Draft.

Other consumer provisions in article 2. In addition to 2-206, there are several other sections in Article 2 that provide special rules for consumers:

- 2-102(a)(8): “consumer contract defined.
- 2-105(a)(2): Other state consumer protection law preserved.
- 2-202(b)(2): Consumer contract excepted from merger clause presumption
- 2-210(b): Consumer excepted from operation of a “no oral modification clause.
- 2-408(c): Consumer must expressly agree to disclaimer of implied warranty.
- 2-409(3): Principles where warranties overlap
- 2-810(b)(2): Remedies where agreed remedies fail intended purpose.
- 2-814(a): Can't reduce 4 year limitation in consumer contracts.

Section 2-207. Effect of Varying Terms.

Consistent with the non-treatment of standard forms, the text of 2-207 in the November, 1996 Draft has been deleted. A new draft with revised notes has been prepared.

Note that the new draft still clings to the belief [in brackets] that a distinction between standard terms and other terms must be preserved. The distinction appears in most cases applying the original 2-207 and the policy reasons for the distinction emerge in these cases.

Section 2-208. Electronic Transactions: Formation

Section 2-209. Course of Performance or Practical Construction.

Section 2-210. Modification, Rescission, and Waiver

Subsection (b) responds the return of the statute of frauds.

Commentators see "conceptual confusion" in 2-210 because the line between modification or rescission by agreement, sub. (a), and modification by waiver is not clear. *To improve clarity, the first sentence in sub. (d) was deleted.*

The terms of an agreement may be modified by a “good faith agreement”, sub. (a), subject to sub. (b). Both parties must agree. The terms of an agreement (usually an express condition) may also be modified by a waiver by one party. An agreement is not necessary for this type of modification. This distinction is made in 2-210, but there is no attempt to fill out or completely define the concept of waiver. **See new 2-702, dealing with the "waiver" of remedies.**

Section 2-211. Electronic Messages; Attribution.

Conform to 2B.

Section 2-212. Intermediaries in Electronic Messages.

Conform to 2B.

Section 2-211 in the July, 1996 Draft, "Delegation of Performance," has been integrated with 2-503 and conformed, to the extent practicable, with 2A-403.

Part 3. General Obligation and Construction of Contract.

Former Part 3 has been divided into two parts, Part 3 dealing with "General Obligation and Construction of Contract" and Part 4 dealing with warranties. Former 2-320 dealing with auctions is now 2-312.

Section 2-301. How Price Payable.

Subsection (c) is revised to conform to the deletion of 2-103(a)(3).

Section 2-302. Transfer at a Single Time.

See Note 1.

Section 2-303. Open Contract Price Term.

See Note 2.

Section 2-304. Output, Requirements, and Exclusive Dealing.

Subsection (a) intends to say that if a party has no output or no requirements in good faith, the "quantity unreasonably disproportionate" clause does not apply. See Note 1.

Section 2-305. Absence of Specified Place for Delivery.

Section 2-306. Time for Performance Not Specified.

See Note 1.

Section 2-307. Options and Cooperation Respecting Performance.

Section 2-308. "Letter of Credit"; "Confirmed Credit".

Section 2-309. Shipment Terms; Source of Meaning.

Section 2-310. Termination; Survival of Obligations.

Coordination says to conform 2 to 2B-628 to the extent relevant to sales.

Section 2-311. Termination; Notice.

See Note 1.

Section 2-311. Auctions.

See Notes, which elaborate issues and judicial development. No recommendation for change for former 2-328 is made at this time.

Part 4. Warranties.

In addition to a separate Part 4, there are a number of changes from the July, 1996 draft that affect the scope of warranty and liability for breach of warranty. The Drafting Committee made even more changes at the November, 1996 meeting.

Section 2-401. Definitions.

The definitions previously in 2-313(a) are stated first and are applicable to all provisions in Part 4.

Personal injury and property loss resulting from breach of warranty.

Here is an overview of how the next Draft will treat personal injury and property loss resulting from an alleged breach of warranty.

Assume first that a buyer of a component from a manufacturer (privity) for installation in equipment claims that a condition in the component caused: (1) damage to the component; (2) a shutdown of part of the factory until repairs and replacement; (3) damage to the equipment in which the component was installed; and (4) personal injury to the buyer and an employee.

First, all loss caused is within the definition of damage in 2-401(1), including personal injury and property damages.

Second, injury to person and property is consequential damage under 2-806. Thus, Article 2 has potential application.

Third, Section 2-319 in the July, 1996 and Section 2-411 in the November, 1996 Draft have been deleted. Except for 2-401(a), 2-806 and 2-810(c), personal injuries are not mentioned or given special treatment. No attempt was made to draft law for the handful of states that use Article 2 in lieu of strict tort liability.

Fourth, the statute does not state when the applicable tort law preempts warranty law in Article 2. Although some guidance is given in the comment to 2-406 (the comment is still open to improvement, **see strongly recommended language from the ALI Council in notes**), the question is left to the courts. To the extent that the goods are defective, tort law should be available. To the extent that express or implied warranties are made that are broader than the test for defect, Article 2 should apply. The Drafting Committee was reluctant to restrict judicial flexibility, particularly where contract expectations are the basis for the claim.

Fifth, beyond this a buyer with personal injury or property damage claims, with one exception, is treated as if the claim were for economic loss. Since the claim arises from a contract the buyer must jump through all the contract hoops, such as the notice requirement, 2-708(c)(1), effective disclaimers under 2-407, and the warranty statute of limitations, 2-814. There is one exception to this “injury neutral” approach: An agreement excluding liability for personal injuries is “prima facie unconscionable.” See 2-810(c).

What about lack of privity? Suppose the defendant manufactured the component, sold it to an “immediate buyer” who installed the component in equipment and sold the equipment to a remote buyer. See 2-401. Regardless of the nature of the claim (personal injury or economic loss), the defendant has the same protection from the remote buyer under Part 4. Moreover, if the

warranty is extended under 2-409, revisions approved at the November, 1996 meeting give the defendant even more protection: (1) The warranty is extended to only buyers and transferees in the vertical chain of distribution. Persons who might use or be affected by the breach are excluded; and (2) A remote buyer under 2-410 cannot recover consequential damages, which include personal injuries, against the seller.

Section 2-402. Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement.

Subsection (e) states a separate statute of limitations for breach of the warranty of title. See Note 3.

Section 2-403. Express Warranties.

This section has been revised to deal with express warranties in direct contractual relationships. See Draft and Notes.

Section 2-404. Express Warranty Obligations to Remote Buyers or Lessees Arising other Than as Part of Agreement of Sale.

Section 2-404 integrates Sections Draft, 2-404 and 2-405 in the November, 1996 Draft. This integration eliminates duplicate language and preserves some language common with 2-403 but highlights the differences in how the obligation is created and what remedies should be available. In both cases, the obligation is created without a contract between the parties.

Subsection (a) deals with the so-called "pass through" warranty [in a record that the seller authorizes another to deliver to a remote buyer or lessee] or affirmations or promises on a container or in a label or on a sample or model delivered to the remote buyer. The obligation is limited to new goods and is subject to the "reasonable person in the position of the remote buyer or lessee" exception in 2-403(a). As between the seller and the remote buyer or lessee, the assumption is that the buyer gets the package for better or for worse. See subsection (e)(1). Thus, if the remote buyer gets an express warranty that he would not otherwise have but there are also disclaimers and limited remedies, the buyer is stuck with the package. Whether the disclaimer or limitation of remedy is "valid" depends upon other sections.

Subsection (b) [2-405 in the November, 1996 Draft] deals with communications to the public, including advertising and follows the structure and style of subsection (a).

Subsection (c) downplays the need for form words of guaranty and warranty and subsection (d) states when the obligation is breached [when the goods are received or the promised performance is not given when due.]

What about remedies for breach of the obligation? Since the obligation does not arise from a direct contractual relation, the question is what parts of Article 2 should apply and what issues should be left to non-code law? Subsection (e) provides a first draft for discussion. See Notes.

Section 2-405. Implied Warranty: Merchantability; Usage of Trade

See the Note on Personal Injury and Property Loss, supra, and the language in revised Note 2. **The ALI's current position is stated.**

Section 2-406. Implied Warranty: Fitness for Particular Purpose.

Section 2-407. Disclaimer or Modification of Warranties.

Subsection (a) follows 2-316(1) in the current code and the interpretation principle would apply in Sections 2-403 and 2-404. Whether an oral express warranty is discharged when a record is subsequently adopted is determined under 2-202.

The general disclaimer principle for commercial contracts is stated in sub. (b)(1). The “safeharbor” for disclaimers in a record is stated in sub. b(2). The language must be conspicuous and satisfy the conditions in (a), (b), and (c) to be effective. Sub.

Section 2-408. Cumulation and Conflict of Warranties.

Section 2-409. Extension of Express or Implied Warranties.

At the November, 1996 meeting of the Drafting Committee, the several changes were made. See Draft and Notes.

Part 5. Transfers, Identification, Creditors, and Good Faith Purchasers.

Section 2-501. Passing of Title; Reservation for Security.

Unique to Article 2.

Section 2-502. Insurable Interest in Goods; Manner of Identification of Goods.

Section 2-503. Assignment of Rights.

This revised section integrates 2-211 of the July, 1996 Draft and conforms in part to 2A-303.

Subsections (a), (b) and (c) are, in the main, former Section 2-209 (1990 Official Text). Subsections (e) and (f) state when attempts to prohibit assignment of rights and delegation of duties by agreement are effective and the consequences of such attempts. Beyond that, 2-403 does not go.

Section 2-504. Power to Transfer; Good-Faith Purchase of Goods.

Section 2-504 is subject to state certificate of title laws through the operation of 2-104(a). The assumption is that 2-504 determines when good title passes unless the certificate of title law clearly provides otherwise. The policy question is whether 2-504 should state the preemptive rule in this area.

Section 2-505. Rights of Seller's Creditors Against Goods Sold.

At the suggestion of the ABA Group, subsection (a) now states when the buyer's rights under 2-724, 2-707 and 2-722(b) are effective against creditors of the seller who has retained identified goods. In essence, it is a first to attach or vest solution. One must look to 2-724, 2-707 and 2-722(b) to determine when the rights vest.

If the buyer's rights vest first, creditors of the seller take subject to them. If the buyer's rights vest after a judicial lien or security interest has attached, the buyer is subordinate unless qualifying as a buyer in the ordinary course of business.

Section 2-506. Sale on Approval and Sale or Return; Special Incidents.

The rights of a seller to goods sold and delivered on approval or under a "sale or return" term against creditors of the buyer are stated in 2-506. Subsection (e) preserves the distinction between "approval" and "return."

Section 2-407 in the July, 1996 Draft has been deleted. Article 2 does not treat consignments, whether for security or not. Assignment issues are resolved under either non-code law or Article 9.

Part 6. Performance

Sections 2-601 through 2-607 and 2-610 were read at the annual meeting. There was little discussion.

Section 2-601. General Obligations.

Subsections (b) and (c) in the July, 1996 Draft have been deleted. See Notes.

[Section 2-602. Service Agreements Relating to Goods.]

This section has been deleted.

[Section 2-603. Waiver of Objection.]

This Section has been moved to Part 7..

Section 2-602. Manner of Seller's Tender of Delivery.

See Note 7.

Section 2-603. Shipment by Seller.

See Notes for revisions made after the September, 1996 meeting of the Drafting Committee.

Section 2-604. Seller's Shipment Under Reservation.

Section 2-605. Rights of Financing Agency.

Section 2-606 .. Effect of Seller's Tender; Delivery on Condition.

Section 2-607. Tender of Payment by Buyer; Payment by Check

Section 2-608. Payment by Buyer Before Inspection.

Section 2-609. Buyer's Right to Inspect Goods.

Section 2-610.. When Documents Deliverable on Acceptance or Payment.

Section 2-611. Open Time for Payment or Running of Credit; Authority to Ship Under Reservation.

Section 2-612. Risk of Loss.

See underlined Notes.

Subsection (d) deals with the effect of breach on risk of loss. See Note 4 and the policy issue raised.

Part 7. Breach, Repudiation, and Excuse

Section 2-701. Breach Generally.

Subsection (c) states when the value of an installment or the whole contract has been substantially impaired by breach. It is based upon the concept of "material" breach in former Section 2-702, *infra*. The January, 1997 Draft does not use the phrase "material breach."

[Section 2-702. Material Breach.]

This section has been deleted. See underlined Notes.

Section 2-702. Waiver of Breach; Particularization of Non-Conformity.

This section integrates concepts previously found in other places. See Section 2-704 of the November, 1996 Draft and Notes.

Section 2-703. Buyer's Rights on Nonconforming Delivery; Rightful Rejection.

_____ The "perfect tender rule", such as it is, has survived so far. **At the ALI Council meeting, Justice Peters expressed again her opposition to the rule.**

In addition to the cited sections, the rejection remedy is limited by the duty to enforce a contract in good faith and by contrary agreement by the parties.

[Section 2-704. Waiver of Buyer's Objections by Failure to Particularize.]

This section has been consolidated with Section 2-603 from the November, 1996 Draft and now appears as Section 2-702 of the January, 1997 Draft.

See Notes.

Section 2-704. Effect of Rightful Rejection and Justifiable Revocation of Acceptance.

Section 2-705. Merchant Buyer's Duties; Buyer's Options as to Salvage.

Section 2-706. What Constitutes Acceptance of Goods.

Section 2-707. Effect of Acceptance; etc.

Subsection (c)(1) has been revised for clarity. The goal is to avoid a draconian result when there is a failure to give prompt notice. The burden is on the seller to establish that it was prejudiced rather than the other way around.

Subsection (e) has been revised to conform in linguistic style to 3-119.

Section 2-708. Revocation of Acceptance.

Section 2-709. Cure.

Section 2-709 [2-710], revised after the September, 1996 meeting of the Drafting Committee, contained a simplified and somewhat broader right to cure than found in the 1990 Official Text. In essence, a buyer who notified the seller of a proper rejection or revocation of acceptance cannot cancel the contract until the seller's cure opportunity is exercised or not.

All agreed that 2-710(1) states the proper rule when the time for performance has not expired, if "conforming delivery" means new rather than repaired good if the contract required new goods.

Under 2-710(2), all agreed that if the buyer rejects because of delay that any attempted cure is not "appropriate and timely." The assumption, unless otherwise agreed, is that time is of the essence. The crucial question is the operation of 2-710(2) where conforming goods rather than time is critical.

Upon reflection at the November, 1996 meeting, the Drafting Committee concluded that "conforming tender" should replace "cure" in (2). Repaired goods are not, in most cases, a conforming tender. In addition, the Drafting Committee concluded that a phrase like "substantially impaired" rather than "appropriate and timely" should be used. The question is whether a conforming tender still substantially impairs the value of the contract to the buyer. This phrase is not a clean fit, and more work is needed. For example, "substantial impairment" is a requirement to revoke acceptance but not to reject. Why should that standard emerge to test whether a tender of conforming goods after the time for performance has passed is appropriate?

A redraft of Section 2-709 appears in the January, 1997 Draft. See Notes.

Section 2-710. Installment Contract; Breach.

Issues arising from the buyer's breach of an installment contract to pay have been deleted from subsection (b).

The phrase "material breach of the whole contract", used in subsections (b) and (c) of the November, 1996 Draft, has been deleted.. See 2-701(c), which defines when a breach substantially impairs the value of the "whole" contract or an installment.

Section 2-711. Right to Adequate Assurance of Performance.

Section 2-712. Anticipatory Repudiation.

See Notes.

Section 2-713. Retraction of Anticipatory Repudiation.

2A and 2B should conform to 2-713.

Section 2-714. Casualty to Identified Property.

See Notes. The more flexible excuse standard could provide more protection to a seller (farmer) who expects to supply the goods from its own land and other sources.

Section 2-715. Substituted Performance.

Section 2-716. Excuse by Failure of Presupposed Conditions.

The buyer's excuse claims based upon frustration of purpose and similar defenses have been removed from 2-716 and left to the common law. See Notes.

Section 2-717. Procedure on Notice Claiming Excuse.

Part 8. Remedies

[A. In General]

Section 2-801. Subject to General Limitations.

Section 2-802. Breach; Procedures.

Section 2-803. Remedies in General.

See Notes, particularly the new material in Note 4, where important policy issues are raised.

Section 2-804. Damages in General.

See new Note 4.

Should Article 2 be clearer on the distinctions between direct, incidental and consequential damages? The issues are important and the lines are hard to draw.. Consider this analysis.

Direct Damages. Direct damages measure the losses resulting from the plaintiff's investment in earning the other party's performance. The buyer pays the price to get the goods and the seller tenders the goods to get the price.

For the buyer, direct damages protect the value of the bargain when the seller fails to perform as agreed. They can include lost profits, reliance and restitution. But the baseline is the expenditures the buyer must make (pay price, costs of transportation and delivery) to obtain the seller's performance. The buyer's best remedy here is specific performance. Other remedies that protect the value of the bargain are "cover and contract/market price damages. Reliance is usually the price paid and, to this extent, overlaps with the restitution interest.

For the seller, direct damages protect the value of the bargain when the buyer breaches. The baseline is the performance which the seller must make to earn the price. The seller's best remedy is an action for the price. Other remedies protecting the value of the bargain are resale and contract/market price damages. Restitution is normally not available to a seller who has

delivered the goods. The seller's reliance interest in performing the contract is expressly recognized in Section 2-821.

These damages are called "direct" because they result from the promised performance. They are rarely too remote or speculative. They are now controlled by Section 2-803 and supplemented by Section 2-804.

Consequential damages. Consequential damages are the damages that result from the plaintiff's inability to use the performance promised by the other party. For the seller, that performance is the agreed price. For the buyer, that performance is conforming goods on time. Sometimes those losses are the profits that would have been made if a conforming performance was timely. If profits cannot be proved with reasonable certainty, the plaintiff may recover foreseeable reliance invested in preparing the use the performance. Since these damages are more remote and speculative, the limitations of 2-806 are appropriate.

To illustrate, suppose the seller agreed to deliver equipment to be used in the buyer's factory by November 1 for \$100,000. In reliance on the contract, the buyer took out a loan to pay the price and spent \$10,000 to install a platform upon which the equipment would rest. The seller repudiated the contract and the buyer "covered" for \$120,000. There was a four month delay in installing the new equipment. The buyer's direct damages are \$20,000, the value of the seller's promised performance. The buyer's consequential damages are the net profits that would have been made if the equipment had been delivered on time, subject to 2-706. If those profits cannot be proved with reasonable certainty, the buyer may recover the \$10,000 expended in building the platform (reliance), subject to 2-806.

Incidental damages. Incidental damages are neither direct nor consequential as discussed above. Rather, they are reasonable expenditures incurred to minimize the consequences of a breach and to facilitate continuing operations. They are closely tied to the mitigation of damages policy. See 2-805.

In sum, Article 2 does not define direct damages for a simple reason: If damages are neither incidental nor consequential they are, in effect, direct. Because I buy into this general analysis, the current Article 2 breakdown seems to be sensible and fair. See Notes to 2-806.

Section 2-805. Incidental Damages.

See new par. (5).

Section 2-806. Consequential Damages.

The "unreasonably disproportionate" language in 2-706(1), although subject to extensive discussion, survived a sense of the house motion to delete it.

Section 2-806 in the January, 1997 draft has been revised and reworked to conform to decisions at the November, 1996 meeting of the Drafting Committee. See underline Notes.

Section 2-807. Specific Performance.

The limitation of 2-822 (action for the price) on the agreed remedy of specific performance is now stated in the text.

The remedy in subsection (c) works even though the buyer is not entitled to recover the

goods under 2-824. See Note 2.

Section 2-808. Cancellation; Effect.

See revised Notes 1 and 2 for discussion of revision made in the January, 1997 Draft..

Section 2-809. Liquidation of Damages; Deposits.

The order of Sections 2-709 and 2-710 in the July, 1996 Draft has been reversed to conform to the 1995 Official Text.

Subsection (a) was revised to conform the decisions made at the September, 1996 Drafting Committee meeting. See Note (1). No distinction between consumer and commercial contracts is made and the court must test the reasonableness of projections made ex ante breach.

Subsection (b)(2) is restored.

Section 2-810. Contractual Modification of Remedy.

The underlined language in subsection (a)(2) illustrates the nature of a minimum adequate remedy.

Alternative B was added after the September, 1996 meeting of the Drafting Committee as the result of a proposal by the ABA Group. See Note 2. Alternative B was adopted at the November, 1996 Meeting of the Drafting Committee.

In subsection (b)(2), the phrase "has other remedies under Section 8-823" has been replaced by "may resort to all remedies provided in this article.

In subsection (c), agreements excluding liability for injury to person are "prima facie unconscionable , not unenforceable.

See Notes.

Section 2-811. Remedies for Misrepresentation and Fraud.

The last full sentence should read: "Rescission or a claim for rescission of a contract for sale and rejection or return of the goods do not bar a claim for damages or other consistent remedy.

Section 2-812. Proof of Market Price.

Section 2-813. Liability of Third Parties for Injury to Goods.

Section 2-814. Statute of Limitations.

See Notes for changes made after the November, 1996 Drafting Committee meeting.

At the ALI Council meeting, some sentiment was expressed for a "discovery" statute of limitations, particularly where building materials and similar goods are involved. In goods of this type, it is difficult to discover non-conformities within the 4 year limitation

period. Since claims for economic loss cannot be brought in tort, purchasers of this type of goods will be disadvantaged. We should review this issue.

[B. Seller's Remedies]

Section 2-815. Seller's Remedies in General.

The seller's remedial options are subject to Part 7, supart A. See 2-801.

Section 2-815 has been revised for clarity and completeness. Breach of the "whole" contract is defined in 2-701(c).

On the relationship of the seller's possessory remedies to Article 9, see Note 2.

Section 2-816. Seller's Right to Reclaim Goods After Delivery to Buyer.

The requirement of "new value" in sub. (b) has been questioned. This limitation upon the priority of after-acquired security will be coordinated with the Article 9 process. Compare 2-824.

Section 2-817. Seller's Right to Identify Goods to Contract Notwithstanding Breach or to Salvage Unfinished Goods.

Section 2-818. Seller's Refusal to Deliver Because of Buyer's Insolvency; Stoppage in Transit or Otherwise.

See underlined Text and Notes.

Section 2-819. Seller's Resale.

Section 2-820. Person in Position of Seller.

Section 2-821. Seller's Damages for Nonacceptance, Failure to Pay, or Repudiation.

This section was revised after the March, 1996 meeting of the Drafting Committee and has not been reviewed by the Drafting Committee. For history, see Note 4.

The measure of damage for repudiation by the buyer of a long-term contract is stated in subsection (a)(2). See Note 3.

The "lost profits" measure is stated in subsection (b). Subject to 2-803, the seller has a relatively free choice between subsection (a) and subsection (b). The lost volume cases fit under subsection (b)(1), but the details are left to the courts. See Note 5.

Section 2-822. Action For Price.

[C. Buyer's Remedies]

Section 2-823. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods.

See the Notes to 2-815, which apply here as well.

Section 2-824. Prepaying Buyer's Right to Goods.

This section states when a prepaying buyer has a right to recover identified goods from the seller, subsection (a), and when the right to recover vests, subsection (b). Creditors of the seller whose claims attach to the goods after the buyer's rights vest take subject to the buyer. If creditor claim attach before the buyer's right vests, the buyer loses unless it is a BIOCB. See 2-505.

2A-522 is the counterpart to revised 2-824. The extent to which it should conform has not been decided.

Section 2-825. "Cover"; Buyer's Purchase of Substitute Goods.

Under 2-803(c), a seller who covered could still sue for damages under 2-826 unless that remedy put the seller in a substantially better position than full performance. Subsection (a)(2), however, reflects the ABA Group's position that a buyer who covers in good faith is barred from damages under 2-826. Presumably, the seller must establish the bar as a defense.

Section 2-826. Buyer's Damages for Nondelivery or Repudiation.

This section was revised after the March, 1996 meeting and has not been reviewed by the Drafting Committee. See Notes to current draft.

Subsection (a)(1) measures damages for repudiation of a long-term contract. See Note 3. The question is whether the phrase "learned of the breach (repudiation) adequately responds to the efficiency and fairness concerns expressed when the buyer, after the repudiation, waits until the time for performance to take remedial action. See Note 3.

Section 2-827. Buyer's Damages for Breach Regarding Accepted Goods.

This section was slightly revised after the March, 1996 meeting and has not been reviewed by the Drafting Committee. See Notes.

Section 2-828. Deduction of Damages From Price.