

UNIFORM COMMERCIAL CODE

REVISED ARTICLE 2 SALES

**NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS**

March 21, 1997 Draft

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) "Authenticate" means to sign or to execute or adopt a symbol, including a digital signal, identifier, or other symbol, [or to do an act that encrypts a record or an electronic message in whole or in part,] with present intent to authenticate a record or term that contains the authentication or to which a record containing the authentication refers. **[2B-102(a)(2)]**

(2) "Between merchants", with respect to a transaction, means between parties both of which are chargeable with the knowledge or skill of merchants. **[2-104(3)]**

(3) "Buyer" means a person that buys or contracts to buy goods. **[2-103(1)(a)]**

(4) "Cancellation" means an act by either party which ends a contract because of a breach by the other party. **[See 2-106(4)]**

(5) "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 a line of machinery; a quantity, such as a gross or carload; or any other unit treated in use or in the relevant market as a single whole. [2A-103(1)(c). See 2-105(6).]

(6) "Conforming" goods or performance under a contract for sale means goods or performance that are in accordance with the obligations under the contract. [2-106(2)]

(7) "Conspicuous", with reference to a term, 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. [The last sentence in the July, 1996 draft was deleted. Compare 1-210(10), 2B-102(6).]

(8) "Consumer" means an individual who buys or contracts to buy goods that, at the time of contracting, are intended by the individual to be used primarily for personal, family, or household use. The term does not include an individual who buys primarily for professional or commercial purposes. [2B-102(a)(7)]

(9) "Consumer contract" means a contract for sale between a seller regularly engaged in the business of selling and a consumer. [individual who buys or contracts to buy goods, that at the time of contracting, are intended by the buyer primarily for personal, family, or household use.]

(10) "Contract" or "contract for sale" means a present sale or a contract to sell at a future date, whether or not the goods are future goods.

(11) "Delivery" means the transfer of physical possession or control of goods.

(12) "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. The term does not include a common carrier employed or used in that

capacity. [2B-102(a)(12)]

(13) "Electronic message" means a record stored, generated, or transmitted for purposes of communication to another party or an electronic agent by electronic, optical, or similar means. The term includes electronic data interchange, electronic mail, facsimile, telex, telecopying, and similar communications. [2B-102(a)(13)]

(14) "Electronic transaction" means a transaction in which the parties contemplate that a contract will be formed by means of electronic messages in which the messages of one or both parties will not be reviewed by an individual. [2B-102(a)(14).]

(15) "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. [2-104(2)]

(16) "Foreign exchange transaction" means a transaction in which one party agrees to deliver a quantity of a specified money or unit of account in consideration of the other party's agreement to deliver another quantity of different money or unit of account either currently or at a future date, whether delivery is to be through funds transfer, book entry accounting, or other form payment order, or other agreed means to transfer a credit balance. The term includes a transaction of this type involving multiple moneys and spot, forward, option, or other products derived from underlying moneys and any combination of these transactions. The term does not include a transaction involving multiple moneys in which one or both of the parties is obligated to make physical delivery, at the time of contracting or in the future, of banknotes, coins, or other form of legal tender or specie.

(17) "Future goods" means goods that at the time of contracting are neither existing nor identified. **[2-105(2)]**

(18) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing. **[2B-102(a)(16)]**

(19) "Goods" means all things, including specially manufactured goods, that are movable at the time of identification to a contract for sale or, unless the context otherwise requires, future goods. The term includes the unborn young of animals, growing crops, and other identified things attached to realty in Section 2-108. The term does not include money in which the price is to be paid, the subject of foreign exchange transactions, documents, letters of credit, information, instruments, accounts, deposit accounts, chattel paper, general intangibles, and payment intangibles.

(20) "Letter of credit" means an irrevocable letter of credit issued by a financing agency of good repute and, if the shipment is overseas, of good international repute. **[See 2-325(3), 5-102(a)(10)]**

(21) "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. **[2A-103(1)(s)]**

(22) "Merchant" means a person that deals in goods of the kind involved in the transaction, a person that by occupation purports to have knowledge or skill peculiar to the practices or goods involved in the transaction, or a person to which knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that purports to have the knowledge or skill. **[2-104(1), 2B-102(a)(26).]**

(23) "Present sale" means a sale that is accomplished by the making of a contract. **[2-106(1)]**

(24) "Receipt":

(A) with respect to goods, means taking deliver; and

(B) with respect to an electronic record or information, means the event of

entering an information processing system in a form capable of being processed by that system which systems the recipient uses or has designated for the purpose of receiving such records or information. **[2-103(1)(c), 2b-102(a)(29)]**

(25) "Record", 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. **[5-102(a)(14), 2b-102(a)(30)]**

(26) "Sale" means the passing of title to goods from a seller to a buyer for a price. **[2-106(1)]**

(27) "Seller" means a person that sells or contracts to sell goods. **[2-103(1)(d)]**

(28) "Standard form" means a record consisting of multiple contractual terms prepared by one party for general and repeated use which is used in a transaction without negotiation of, or changes in, the substantial majority of the standard terms. Negotiation or customization of price, quantity, method of payment, standard options, or time or method of delivery does not preclude a record from being a standard form. **[2B-102(a)(34) except that “quantity” rather than “volume” is used.]**

(29) "Standard terms" means terms prepared in advance for general and repeated use by one party. **[2B-102(a)(35)(1996); UNIDROIT Principles, Art. 2.19(2)]**

(31) "Termination" means an act by a party, under a power created by agreement or law, which puts an end to a contract for a reason other than for breach by the other party. **[2-106(3), Conformed to 2A-103(1)(z), except that “breach” rather than “default” is used. See 2B-102(a)(37).]**

(b) The following definitions in other articles apply to this article:

"Check". Section 3-104(e).

[Other relevant definitions will be provided in the July, 1997 Draft.]

(c) In addition, Article 1 contains general definitions and principles of construction that apply throughout this article.

SOURCES: Sales (July, 1996); Licenses (October, 1996).

Notes

1. These definitions come primarily from the July, 1996 Draft of Article 2, which, in turn, drew upon the October, 1995 and the May, 1995 Drafts. Sources not noted come from the 1990 Official Text of Article 2. Other definitional sources include Article 2A, Article 2B, Licenses (January, 1997) and the UNCITRAL Draft Model Law on EDI. Definitions that relate primarily to licenses have been excluded from this Draft.

2. Following the Sept. 1996 meeting of the Article 2 Drafting Committee, the last sentence in the July, 1996 definition of "conspicuous" was deleted. Rather, the situations listed in that sentence will be noted in the comments as factors to be considered rather than as conditions to establishing a safe harbor. Unlike 1-201(10), the definition does not state that the decision on conspicuous is for a court as a matter of law. Depending on the circumstances, the decision is for the trier of fact. The definition does not conform to 2B-102(a)(6)(Nov. 1996).

The policy questions are whether (1) compliance with any one of the "factors" in the last sentence should constitute a "safe harbor" and (2) the court or jury should decide the question. What ever definition is agreed, it should ultimately be in Article 1.

3. The July, 1996 Draft contained three alternative definitions of good faith. At the 1996 Annual Meeting, the Conference voted to adopt a modified version Alternative C. Alternative C provided that "good faith" means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the conduct or transaction concerned." The Conference voted to delete the phrase after "fair dealing" and follow the definition in 3-103(a)(4). Accord: 2B-102(a)(16). This is not a significant change, since the duty of good faith applies to the "performance and enforcement" of the contract. Section 1-203. But see 5-102(a)(7) which provides that good faith means "honesty in fact in the conduct or transaction concerned."

4. The July, 1996 Draft contained four new, important definitions: Standard form, standard term, manifest assent and opportunity to review. As a matter of policy, the March, 1997 Draft conforms to Article 2B on the definition of "standard form" and "standard term". **Section 2-103 on "manifesting assent" and "opportunity to review", however, was deleted at the November, 1996 meeting of the Drafting Committee. See revised 2-206, which relies upon other concepts. See also, 2B-112 and 2B-113.**

5. Article 2 follows Article 2B in all definitions relating to electronic contracting.

SECTION 2-103. SCOPE.

(a) Unless the context otherwise requires, this article applies to transactions in goods.

(b) If a transaction involves both information and goods, this article applies to the aspects of the transaction which involve the goods and their performance and rights in the goods other than the copies, packaging, or documentation pertaining to the information. However, this article applies to a sale of a computer program that was not developed specifically for a particular

transaction if that program is embedded in goods other than a copy of the program or an information processing machine unless the program is copied in the ordinary course of using the goods or is the subject of a separate license with the buyer. [2B-103(c) & (d)(3)]

(c) Except as otherwise provided in subsection (b), if another article of this [Act] applies to a transaction in goods, this article does not apply to the part of the transaction governed by the other article. [2b-103(b)]

(d) This article does not apply to a foreign exchange transaction.

Notes

1. Article 2 covers “transactions in goods” unless the context otherwise requires. Normally this transaction is a contract for sale and many sections in Article 2 are expressly limited to contracts for sale. Although a “pure” service contract is not covered, the courts have applied Article 2 to mixed transactions of goods and services if the sale of goods “predominates” and, occasionally, they have applied Article 2 to disputes over the quality of goods furnished in a transaction where services predominate. These situations will be illustrated in the comments.

2. Subsection (a)(3) in the November, 1996 Draft stated that Article 2 applied to a common type of service contract where the seller, not a third person, agreed to install, service and repair goods sold at or after the time for delivery. Standards for measuring the seller's obligation in these contracts and appropriate remedies were provided in new Section 2-602. **Subsection (a)(3) and 2-602 were deleted at the November, 1996 meeting of the Drafting Committee.**

4. Although not stated in §2-103, courts may 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). Also, by including “transactions in goods” in subsection (a), courts may apply Article 2 to transactions that are not sales unless the particular sections that apply are limited to contracts for sale.

5. Embedded software. Subsection (b) deals with transactions where both goods and information licensed under Article 2B are involved. See 2B-103 on the scope of Article 2B. Presumably, Article 2B governs all disputes over “licenses of information and software contracts” and “related support and maintenance agreements. 2B-103(a). Article 2, however, may apply to transactions excluded from Article 2B under 2B-103(d). Thus, a “sale or lease of a copy of a computer program that was not developed specifically for a particular transaction if the program is “embedded in goods” is excluded by 2B-103(d)(3) and is governed by Article 2.

6. Subsection (c), which is subject to subsection (b), delineates the line between Article 2 and other articles in the UCC, without attempting to define it. It follows 2B-103(b). **Query: Does the phrase “does not apply” adequately cover transactions where Article 2 and another article both apply to the same issue, such as the effect of a full payment check and certain document of title transactions?**

7. **Foreign exchange contracts, which are defined in 2-102(a)(17), are excluded from Article 2. The definition and the exclusion are based upon a recommendation by the Federal Reserve Bank of New York. Except for the “multiple moneys” exclusion where the contract requires the delivery of tangible forms of money, the transaction is governed by general contract principles and Article 4A.**

SOURCES: 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:

(1) [list any certificate of title statutes covering automobiles, trailers, mobile homes, boats, farm tractors, or the like], except for a buyer in the ordinary course of business under Section 2-504(d) whose rights arise before a certificate of title covering the goods is issued in the name of the buyer:

(2) any applicable consumer protection statute of this State or final consumer protection decision of a court of this State, existing on the effective date of this article; or

(3) [list any other law of this State to which this article is subject];

(b) In the case of a conflict between this article and a statute or decision referred to in subsection (a), the statute or decision governs.

(c) Failure to comply with a statute or decision referred to in subsection (a) does not itself constitute a breach of contract or affect the applicability of this article.

SOURCES: 2A-104. See 2B-104.

Notes

1. Section 2-104 helps to determine what other law of "this state" governs a contract for sale otherwise within the scope of the Article 2. It is a more particularized application of the displacement principle in 1-103. The extent to which the law of another state governs is determined by applicable choice of law principles, see 1-105, or an enforceable choice of law clause. See 2B-106(Nov. 1996). Article 2 does not deal with choice of law or choice of forum..

Article 2 takes no position on the following questions: (1) To what extent can the parties agree that Article 2 does not apply even though the transaction is a contract for sale; (2) To what extent can the parties agree that Article 2 applies to a transaction that is not a contract for sale, see 2B-105(Oct. 1996); and (3) To what extent should a court extend Article 2 by analogy to a transaction that is not a sale, see 2A-102, comment.

2. Section 2-104(a)(1) states that a transaction covered by Article two is subject to any

applicable "certificate of title statute of this state. Thus, if the applicable CTA provided a different rule than 2-504 on transfer of good title, the CTA would apply. Given the complexity and on-uniformity of various CTAs, the policy question is whether Article 2 should provide the uniform, preemptive rule and, if so, whether 2-504 states the proper rule? **At the January, 1997 meeting of the Drafting Committee approved an exception for a buyer in the ordinary course of business whose rights arise before a certificate of title covering the goods is issued in his name was approved. Thus, a BIOCB of a new car from a dealer to whom a certificate of origin was issued or from a used car dealer in possession of a certificate of title in the name of another person will be protected under Article 2.**

3. Subsection (a)(1) in the July, 1996 Draft provided that Article 2 was subject to any applicable "federal law to the extent it governs the rights of parties to, and third parties affected by, the transaction. This was deleted because it stated the obvious: federal law either preempts or it does not, although the preemption line is not always clear.

For example, 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, Art. 2(a), or the subject of the sales was an "aircraft" or "electricity." Art. 2(d) & (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", Art. 4, and "does not apply to the liability of the seller for death or personal injury caused by the goods to any person." Art. 5. Article 2 applies to "validity" disputes involving unconscionability, §2-105, claims for personal injury resulting from a breach of warranty, §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 §2-404 & 2-308(a). Since Article 2 does not define "seller" to exclude a seller under CISG, to the extent that lack of privity is not a defense a remote United States buyer of imported goods presumably can sue a Canadian seller for breach of warranty under Article 2.

3. Although Article 2 assumes that a court will adjudicate the dispute, the parties may select the forum by agreement or agree that the dispute will be adjudicated in arbitration. Unless otherwise stated, the use of the word "court" in Article 2 includes alternative tribunals to which the parties may turn by agreement for adjudication.

SECTION 2-105. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court finds as a matter of law that a contract or a term 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 term, or so limit the application of the term 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 term 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 §2-302 in the 1990 Official Text. Section 2-105 does not adopt the broader language of §2A-108. A proposal to conform original §2-302 to §2A-108(2) & (3) was rejected by the Drafting Committee at the October, 1993 meeting. The phrase "induced by unconscionable conduct," taken from §2A-108(2), was added and approved at the Annual Meeting of the Conference in July, 1996. The "induced" phrase, however, does not appear in 2B-109(Nov. 1996). See 2A-108, comments, and Uniform Consumer Credit Code 5.108, Comment 1.

What is "unconscionable conduct" that induces a contract that is otherwise conscionable? Possible examples include cases where excessive pressure is placed upon senior citizens (a used car dealer takes the keys to the car of prospective buyers and won't let them leave for food or medication until they buy the used car) or the contract is presented in a manner so that the purchaser cannot see that an important term has been changed. In short, the conduct approaches but does not clearly reach defenses such as duress or fraud. **These examples and the concept of "inducement" were criticized at the Meeting of the ALI Article 2 Consultative Group in November, 1996. The issue will be revisited after revised 2-206 is completed.**

2. The expanded treatment of consumer contracts and standard form contracts in Article 2 is a particularized application of unconscionability concepts. See, e.g., §§2-206 and 2-316. Nevertheless, §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 §2-316(b) or a standard form to which a commercial party has manifested assent, 2-206(a), may still be unconscionable on other grounds. Those grounds, however, are limited to cases where there was little or no opportunity in the market to find needed goods with different terms and where the terms offered were unreasonably favorable to the buyer or seller. These cases are few and far between. See, e.g., *Martin v. Joseph Harris Co., Inc.*, 767 F.2d 296 (6th Cir. 1985).

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. Moreover, the court or other tribunal rather than a jury determines whether a "contract or any clause thereof is unconscionable."

There are very few cases in the last 10 years where the courts have found a contract or clause unconscionable under former 2-302. Of the fourteen cases found, nine involved issues arising only under Article 2 and most involved the enforceability of agreed limitations on warranties and remedies. These cases, however, do not include those arising under 2-207 where

findings of unfair surprise excluded terms from the agreement.

SECTION 2-106. 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 in future goods 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 2-107. GOODS TO BE SEVERED FROM REAL PROPERTY;
RECORDING.**

(a) A contract for the sale of minerals, oil, gas, or similar things to be extracted, or a structure or its materials to be 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 2-107 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. Similarly, the undefined phrase "contract to sell" [found in the original Article 2] was replaced by 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."

2. After the 1996 Annual Meeting of the Conference, subsection (a) was revised to clarify that "minerals, oil, gas, or similar things" are to be "extracted" from the real property and structures are to be "removed" from the property. In some states, underground mineral deposits may be called structures. Also, it is clear that water is a thing similar to oil and gas. Article 2 applies to the sale of water after it is extracted not to the sale of the right to extract.

3. What about long-term sale and leaseback of buildings and structures? In typical cases, an owner of improved or unimproved land will convey it and then take a leaseback for a term of years. At some point in the leaseback, the lessee (formerly the owner) has a right to remove and, presumably, sell structures on the land. In general, Article 2 does not apply to this transaction even though the owner has a right to sever and sell. If, however, the owner actually sells the structures to a third person and reserves the right to sever, that transaction is covered by 2-107.

SECTION 2-108. EFFECT OF AGREEMENT.

(a) Except as otherwise provided in Section 1-102 and this article, the effect of any provision may be varied by agreement.

(b) The absence of a phrase such as "unless otherwise agreed" does not by itself preclude the parties from varying the provision by agreement.

(c) Whenever this article allocates a risk or imposes a burden as between the parties, an agreement may shift the allocation and apportion the risk or burden.

Notes

1. Section 2-108 retains the general principle of Section 2-109(a) of the July, 1996 Draft but deleted subsection (b), which purported to list those sections which could not be limited or varied by agreement. In the view of the Drafting Committee, subsection (b) duplicated the principle of variance in 1-102(3) and posed an unacceptable risk of unintended under and over inclusion in the drafting. Compare 2B-114.

2. Without purporting to make an exclusive statement, the comments should identify the sections which specifically prohibit variation. See, e.g., 1-203 & 2-102(a)(19), 2-202(b), 2-106, 2-316(a) and 2-318. See also, 2-710(a), §2-403, and §2-714(a).

It has been suggested, again, that subsections (a) and (b) duplicate material in 1-102 and should, therefore, be deleted. Does the Drafting Committee agree? If so, subsection (c) must be relocated to Part 3.

PART 2

FORMATION, TERMS, AND READJUSTMENT OF CONTRACT

SECTION 2-201. FORMAL REQUIREMENTS; STATUTE OF FRAUDS;

SEALED INSTRUMENTS.

(a) Except as otherwise provided in this section, a claim for breach of contract for sale in the amount of [\$5,000] or more is not enforceable by way of action or defense against a person that establishes by credible evidence that no oral contract was made unless there is a record authenticated or sealed by the person against which the claim is asserted as the record of that person which is sufficient to indicate that a contract was made. A record is not insufficient merely because it omits or incorrectly states a term, including a quantity term. If the record contains a quantity term, the claim is not enforceable beyond that quantity.

(b) If an authenticated or sealed record in confirmation of a contract which is sufficient against the sender is sent within a reasonable time to the other party, the record is sufficient against a merchant, including a farmer, unless the merchant sends a notice of objection to the record within 10 days after the record is received.

(c) A claim for breach of contract otherwise barred under subsection (a) is enforceable if:
(1) the goods are to be specially manufactured or processed for the buyer and the seller substantially manufactures or processes the goods in good faith performance of a contract believed to exist and the seller cannot resell the goods at a reasonable price;

(2) the conduct of the parties in performing the agreement recognizes that a contract was formed; or

(3) reliance by one party on representations or an agreement estops the other party from raising the lack of a sufficient authenticated or sealed record as a defense.

(d) A claim for breach of contract enforceable under this section is not unenforceable on the ground that it is not capable of being performed within one year or any other applicable period after its making.

(e) Except as otherwise provided in subsection (a), affixing a seal to a record evidencing a contract for sale 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

Section 2-201(a) in the November, 1996 draft abolished the statute of frauds for Article 2. This result was strongly recommended by the PEB Study Group and 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 and 1996 Annuals Meeting of NCCUSL.

However, at the November, 1996 meeting, the Drafting Committee decided to restore “some version” of the statute of frauds. Section 2-201 of the November, 1996 Draft, based upon the able draft by Professor W. David East, clarified the text without making it harder to satisfy the statute.

At the January, 1997 meeting of the Drafting Committee, a further revision that makes it easier to satisfy the statute was submitted by Curtis Reitz was approved in principle. The key concepts are as follows.

1. Subsection(a) follows original 2-201(1), with some important differences:

The diminimus amount of \$10,000 is used, pending further research.

The statutes of frauds defense cannot be raised under subsection (a) unless the person against whom a claim or defense is asserted establishes by credible evidence that no oral contract exists. The implication is that the court will conduct a preliminary hearing, much like that expected under 2-202, to determine whether the claim of an oral contract rests upon credible evidence. If so, the defense is not available. Moreover, subsection (c)(2) states that even if there is no credible oral agreement, conduct by both parties recognizing the existence of a contract removes the case from the statute.

A record is sufficient if it is authenticated or sealed. See 2-201(e).

A record is not insufficient because it omits a quantity term. Although there is no Article 2 “gap filler” for quantity, the term may be established by relevant evidence, including trade usage and course of dealing. If, however, a quantity term is included in the record

the claims is not enforceable beyond the quantity stated.

2. Subsection (b) retains the confirmation principle in 2-201(2) with the following change:

The text states that only the recipient of the confirmation must be a merchant. “Merchant may include a farmer. This rejects cases that hold that farmers can never be a merchant and leaves the question when a farmer is a merchant to the particular case. See 2-102(a)(22). See also, 2-201 (1995), comment 2, paragraph 2, which states that the merchant concept under 2-201(2) rests “on normal business practices which are or ought to be typical of and familiar to any person in business.

As in subsection (a), the phrase “authenticated or sealed” is used. The authenticated record must be sufficient against the sender. The theory is that a merchant who does not object to an authenticated, sufficient record sent by the other party is estopped to raised the statute of frauds defense.

3. Subsection (c) states when a claim otherwise barred under subsection (a) or (b) is “nonetheless enforceable.

Subsection (a)(1) is revised for clarity. In most cases, the duty of good faith, 1-203, is not imposed on conduct relating to an unenforceable agreement.

Subsection (a)(2) expands the “part performance” exception in 2-201(3)(c)(1995). Conduct by both parties, including part performance, takes the case out of the statute. To illustrate, suppose S claims the breach of an alleged oral contract to supply the buyer’s requirements over a 5 year period. After six months, the buyer requests, the seller delivers and the buyer accepts requirements for that period. Later the buyer repudiates and raises the statute of frauds defense. Assuming that the defense is proper under subsection (a), the conduct of both parties recognizes a contract and the defense is no longer available. In short, the seller’s claim of a five year contract goes to the trier of fact.

Subsection (a)(2) recognizes that reliance on representations or an agreement by one party “may estop” the other from raising the statute of frauds defense. Whether estoppel exists depends upon the particular case. Presumably, the court will be guided by Restatement (Second) Contracts sec. 139, one factor of which is the extent to which the reliance “corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence. See Sub. (2)(c).

Subsection 2(b) of former 2-201, dealing with “admissions” has been deleted. The issue is now covered by the requirement of a preliminary hearing under subsection (a).

4. Subsection (d) is new. See 2-201(a) (Nov. 1996). The phrase “any other applicable period” recognizes that some state statutes apply to periods longer than one year.

5. Subsection (f) is 2-201(b) in the November, 1996 Draft and 2-203 in former Article 2.

SECTION 2-202. PAROL OR EXTRINSIC EVIDENCE.

(a) Terms on which confirmatory records 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 contemporaneous oral agreement. However, the terms may be explained or supplemented by evidence of:

(1) course of performance, usage of trade, or course of dealing; and

(2) [noncontradictory] additional terms that if agreed upon would certainly not have been included in the record, unless the court finds that the record was intended as a complete and exclusive statement of the terms of the agreement.

(b) Except in a consumer contract, a contractual term indicating that the record is a complete and exclusive statement of the agreement of the parties is [presumed to state] conclusive evidence of the intention of the parties. Otherwise, the court shall consider all evidence relevant to the intention of the parties to integrate the record.

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

Notes

1. If, after a preliminary hearing authorized by §2-202(b)(1), the court concludes that the parties intended a partially integrated writing, §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 an additional term that if agreed upon would not certainly have been included in the record. This latter ground for admissibility changes original §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 §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 2B-301(a)(2), 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 §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. **At the September, 1996 meeting, the Drafting Committee voted to include 2-201(b)(2), limiting the effect of the presumption to contracts other than consumer contracts. See 2B-301(b)(Alternative 2), stating that a merger clause not in a standard form is "presumed**

to state the intent of the parties on this issues."

Given the controversy over this decision, revised and underlined subsection (b) is offered as a solution: In commercial cases, a merger clause is conclusive on intention. In consumer contracts with merger clauses and all other cases where an intent to integrate is claimed, the court shall conduct a preliminary hearing where all relevant evidence on intention shall be considered.

3. In the case of either a partial or a total integration, terms in the record may be "explained" and also may be "supplemented...by course of dealing or usage of trade or by course of performance" §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 §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, §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. Nevertheless, many still argue that a merger clause in commercial contracts should be conclusive.

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 §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 Art. 8(3).

Despite a contrary recommendation by the Coordination Committee, the Article 2 Drafting Committee voted (September, 1996) to retain subsection (b)(1) which requires the court to conduct a preliminary hearing on whether the parties intended to integrate the record. The last clause, dealing with type of evidence relevant to the intention question, however, was deleted at the November, 1996 meeting. Subsection (b) of the January, 1997 Draft now excludes commercial contracts with a merger clause from the requirement of a hearing.

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 §2-202(b)(1) 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 §2-316(a), or (2) a device to exclude other terms agreed in the negotiating process. See §2-302. The Drafting Committee voted to retain 2-202(b)(1) at the September, 1996 meeting.

SECTION 2-203. FORMATION IN GENERAL.

(a) A contract may be made in any manner sufficient to show agreement, including by offer and acceptance or conduct of both parties recognizing the existence of a 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 the records of the parties do not otherwise establish a contract.

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

(d) Language in a record which expressly conditions the intention to contract upon agreement by the other party to terms in the record must be conspicuous.

SOURCE: Sales, Section 2-204.

Notes

1. In transactions where terms in the records of one or both parties appear to prevent agreement, the issue of contract formation is treated in §2-203(b) and §2-205(a)(1) rather than former 2-207. One looks there to determine whether a contract has been formed. If some contract is formed, the question of what terms in a record are included in the agreement is treated in new §2-206 where consumer contracts are involved and revised §2-207.

The last clause in §2-203(b) deals with contract formation where the parties intend to make a contract but varying 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 §2-207(3). Thus, if there is conduct by both parties which recognizes the existence of a contract but terms in their records do not agree, a contract is still made under §2-203(b).

2. Under basic contract law, either party can condition the formation of a contract upon agreement by the other party to terms proposed. See 2-207(1) (1990 Official Text). Subsection (d) deals with the case where either the offeror or the person purporting to accept an offer expresses that condition in a record: The condition is not effective unless the language is conspicuous, see 2-102(a)(7). Suppose, for example, that the seller's offer, made in a record that notice of any breach of warranty must be given within 30 days of when the buyer "should have discovered" the breach and that the seller "will not be bound" unless the buyer agrees to the seller's terms. That language conditioning intention to be bound is not effective unless it is conspicuous. Whether it is conspicuous or not may depend upon whether the language is in

standard terms or “boilerplate.

3. 2B-202 omits subsection (d) and contains two other differences: (1) The phrase “actions of electronic agents” is included in subsection (a); and (2) the phrase “one party reserves the right to modify terms” is inserted in subsection (b).

4. In November, 1996, the Drafting Committee decided to eliminate all references to “standard forms” and “standard terms” in Sections 2-203, 2-205 and 2-207. This approach was reaffirmed at the January, 1997 meeting of the Drafting Committee and all bracketed references to standard terms have been deleted.

SECTION 2-204. FIRM OFFERS. An offer by a merchant to enter into a contract made in an authenticated 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 a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term of assurance in a record supplied by the offeree to the offeror is ineffective unless the term is conspicuous.

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

Notes

1. The September 10, 1993 draft of §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 §2-205, imposing a three month limit, was subsequently approved. See 2B-203.

2. At the September, 1996 meeting, the Drafting Committee voted to replace the word “conspicuous” in the July, 1996 Draft with “manifests assent.” See 2B-303, last sentence. It protects an offeror against surprise when the firm offer is in a record, frequently a standard form, prepared by the offeree to be used by the offeror. **With the deletion of 2-103 and the concept of “manifests assent”, the word conspicuous has been restored.**

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 invites acceptance in any manner and by any medium reasonable under the circumstances, including a definite expression of acceptance in a record that also contains terms varying the offer.

(2) An order or other offer to buy or acquire goods for prompt or current shipment

invites acceptance by a prompt promise to ship or by prompt or current shipment of 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 that is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

SOURCE: Sales, Section 2-206.

Notes

1. Section 2-204 and Section 2-205 [formerly Section 2-206] were revised to state that, in the "battle of the forms" and other disputes over records, 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 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" in a record accepts an offer even though it contains terms varying the terms of an offer. These principles were previously found in Section 2-207(1) and (3) of the 1990 Official Text. Compare 2B-204(a).

Although the statute does not say so, it is unlikely that a definite acceptance with varying terms in the same record will be found unless the varying terms are in the "boilerplate."

2. The formation test in §2-205(a)(1) follows that in the original §2-206(1). Unless the offer clearly provides otherwise, a definite acceptance creates a contract even though the acceptance contains terms in a record that vary the offer. Unlike the Restatement, Second and Article 19 of CISG, a definite acceptance containing a terms that materially vary the terms of the offer can create a contract. The offeree can avoid a contract by expressly stating that no contract exists unless the offeror agrees to the offeree's standard terms. See 2-203(d). 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 conspicuous when contained in a record. 2-203(d).

Here are some examples.

Example #1. After negotiations where no agreement was reached, B sent S an offer in a record 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 2-205(a)(1), which reinforces §2-203(a). B clearly accepted the offer and the seller's record did not conspicuously indicate by language or otherwise

that there would be no contract unless S agreed to all of the terms proposed.

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 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 §2-203(d). Whether B's arbitration clause or S's exclusion clause are part of the contract depends upon §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 §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 terms in the records prepared by the parties become part of the contract is determined by §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 §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 §2-207, the "default" rule is that the seller may litigate.

Example #4. Suppose that terms in the records of both parties conspicuously state that there will be no contract unless their terms are agreed to by the other party. See §2-203(d). The seller ships and the buyer accepts the goods. There is a contract under §2-203(a) & (b). The agreement of the parties includes the terms stated in 2-207.

3. 2-205 conforms to 2B-204 in that the phrase "invites acceptance" is substituted for the "must be construed as" language. The response by an "electronic agent" is treated in 2B-204(c). Both 2A-206 and 2B-204 omit subsection (b) of 2-205.

4. Recent cases and revised Article 2.

Two recent cases in the Seventh Circuit, *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), and *Hill v. Gateway 2000, Inc.*, ___ F.3d ___, 1997 WL 2809 (7th Cir. 1997), raise questions about the adequacy of the proposed contract formation provisions in Part 2 and the operation of the new "pass through" warranty provision in 2-404(a). Both were decided by Judge Easterbrook.

In *ProCD* the defendant, an individual, bought software with a "shrinkwrap" license from a retailer in a transaction that appears to satisfy the evolving definition of "mass market" in 2B-102(a)(25). When D paid and took possession of the disk he was told that there were terms on the inside. The key term was in fact a license and D was informed, both in the standard form record and on the computer disk, that he had an option to accept the license or reject it and return the software for a refund. D used the software, violated the license and was sued by P, the producer. The court, in reversing the district court, enforced the license. Among other things, the court concluded: (1) The dispute involved a single form not a "battle of the forms" under 2-

207; (2) Section 2-204(1), augmented by 2-606, supported the view that the parties intended to conclude the contract when D accepted the terms of the license by using the program, not when D paid for and took delivery of the disk. The court rejected the argument that D was bound only by terms disclosed at the time of payment and possession; and (3) Article 2, which the court applied to the license of goods, did not require that the terms in dispute be conspicuous or be presented in any particular way. Section 2-302 was not discussed. Nor was a possible analogy to 2-207(1)& (2), which supports the view that a contract can be formed along with a proposal to modify the contract.

In Gateway, the defendant, responding to advertising, ordered a computer directly from Gateway, the manufacturer. D paid for the computer by credit card before it was shipped and was unaware, at that time, of the terms of the contract. The computer arrived in a box with no external message that there were terms inside. The terms inside contained, inter alia, a limited express warranty, a service commitment and an agreement to arbitrate. The record also stated that the purchaser would be bound to the terms unless the computer was returned within 30 days. D did not object in time and, when warranty claims were made, Gateway demanded arbitration. The district court refused to order arbitration and, upon appeal, the decision was reversed: D had agreed in writing to arbitrate by failing to object in time. Once again, the court rejected 2-207 as inapplicable and affirmed the approach of ProCD to formation under Article 2. More importantly, the court rejected any claim that D was surprised by the terms and imposed the primary responsibility to discover, understand and respond to the standard terms on the purchaser: [T]he Hills knew before they ordered the computer that the carton would include some important terms, and they did not seek to discover these in advance. Even though they did not learn of the terms in advance, they inspected the documents after delivery and did not exercise their option to avoid the contract and obtain a refund.

Questions:

1. Does Article 2 adequately support the court's conclusion that the contract is not formed and the proposed terms not included until the buyer has an option after paying for and taking possession of the goods to accept the terms or reject and return the goods for a refund. If not, what revisions should be made to respond to transactions of this type?

2. Does Article 2 adequately neutralize the risk of unfair surprise in these cases? If not, what revisions should be made?

SECTION 2-206. CONSUMER CONTRACTS; STANDARD FORM RECORDS.

(a) In a consumer contract, if a consumer agrees to a record by authentication or affirmative conduct,

Alternative A

any non negotiated term that a reasonable consumer in a transaction of this type would not expect to be in the record is excluded from the contract.

Alternative B

any term of which the consumer is not expressly aware is excluded from the contract if a

reasonable consumer in a transaction of this type would not expect to find that term in the record.

Alternative C

if the preparer of the record had reason to know that the consumer would not agree to the record if it knew of a term contained in the record, that term is excluded from the contract.

(b) Before excluding a term under subsection (a), the court, on motion of a party or its own motion, after affording the parties a reasonable and expeditious opportunity to present evidence on whether the term should be included or excluded from the contract, shall decide the question as a matter of law. Evidence as to whether a term would be expected by a reasonable consumer in a transaction of this type, includes:

(1) efforts by the party preparing the record to inform the consumer of the term, including:

(A) the setting and circumstances in which the form was presented to the consumer;

(B) whether the term was called to the consumer's attention, including by a prior course of dealing between the parties, if any; and

(C) the degree to which the seller, or any other person on the seller's behalf, publicized the terms of the type of sale involved, including the term in dispute; and

(2) facts from other sources that are relevant to the expectations of reasonable consumers, including:

(A) the nature, price, and description of the goods;

(B) the expectations of consumers in similar types of transactions; and

(C) usages, standards, and common practices with respect to goods of the same type or description.

(c) If the seller complies with other more specific requirements in this article for including terms in a consumer contract, this section does not exclude those terms.

SOURCE: New.

Notes

1. This section expands 2-206(b) of the November, 1996 Draft and revises it to conform to decisions made at the January, 1997 meeting of the Drafting Committee. The question is when a consumer who authenticates or by affirmative conduct appears to agree to a record is not bound by the terms in the record. The answer in a consumer contract is when a term is not negotiated and a reasonable consumer in this type of transaction would not expect it. Subsection (a). A negotiated term is included. In this draft, no distinction between standard and non-standard terms is made.

When is a term negotiated? At a minimum, the consumer should be aware of the term and, perhaps, have an opportunity to review. At a maximum, the consumer should not be required to take the term or leave it after awareness. There must also be an opportunity to bargain over the term's inclusion or content. This latter opportunity is rare in modern consumer contracts.

Which conception of negotiation does the Drafting Committee wish to endorse? If the primary purpose of 2-206(a) is to prevent unfair surprise caused by the present of an unexpected term, then a minimum concept seems appropriate. Accordingly, Alternative B substitutes the phrase "expressly aware" for negotiated. If the particular consumer is expressly aware that the record contains a particular term, i.e., a disclaimer, then it is included even though a reasonable consumer may not be aware of it.

Alternative C, taken from Section 211(3) of the Restatement (Second) of Contracts, further sharpens the choices and appears at the request of Commissioner Jerry Bepko.

Other choices to test inclusion (not contained in this draft) include: (1) agreement in fact subject to general unconscionability; (2) express agreement as opposed to express awareness; and (3) mass marketing concepts, including the requirement of an opportunity to review.

2. Subsection (b) gives the parties the right to a hearing and indicates the source and type of evidence that may be relevant to a reasonable consumer's expectations in a transaction of this type. The court decides the question as a matter of law. See 2-106(b). The usual burdens of proof apply, e.g., if the consumer seeks to exclude the term the consumer must establish the conditions for exclusion.

Subsection (b)(1) identifies possible sources of evidence relevant to the whether a reasonable consumer in a transaction of this type would expect the term.

3. Subsection (c) states that if the term is included in a consumer contract under the more particular requirements of another section in Article 2 it will not be excluded under 2-206.

Not all records are standard forms but many records contain standard terms, usually preprinted. This draft does not distinguish between standard and other terms in a consumer contract. **Should it?** Arguably, the risk of surprise is greater when a consumer gives assent to a record with standard terms than when the record deals with price, payment or quantity.

SECTION 2-207. TERMS OF THE CONTRACT; EFFECT OF VARYING

TERMS IN RECORDS. Subject to Sections 2-202 and 2-206, if a contract is formed under this

article and the parties have exchanged records or one party has confirmed a contract by a record, the contract includes:

- (1) terms on which the records of the parties agree in substance;
- (2) in a record confirming a contract, terms that do not materially vary the contract and are not objected to in a timely manner;
- (3) terms to which the parties have otherwise agreed, unless the inclusion would result in unfair surprise or hardship to one party; and
- (4) terms supplied or incorporated under any other provision of this [Act], including applicable usage of trade, course of dealing, and course of performance.

Notes

1. Drafting History. 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 §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. One objective was to neutralize any strategic advantage gained where standard terms were used (although §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 assumed 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 apparently assenting by conduct.

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 §§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 §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 §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 §2-206, covering "Standard Form Agreements," and the new definitions to deal with most unfair surprise and advantage taking, the May, 1995 Draft of §2-207 was limited to "conflicting" standard terms. i.e., terms which vary other terms by adding to or contradicting them.

In October, 1995 the Drafting Committee decided to limit §2-206 to cases where all of the agreement was contained in a standard form record. Section 2-207, therefore, was reworked to deal with the unstructured, partially negotiated transaction where standard terms are contained

in the records [not standard forms] of one or both parties. Revised §2-207 in the July, 1996 operated as follows:

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

Second, Section 2-206, where all of the terms were contained in a standard form or a record containing standard terms, did not apply. If it applied, §2-207 did not.

Third, Section 2-207 applied where one or both parties used records [not standard forms] and the record contained standard terms which varied [added to or differed from] materially the terms [standard terms, negotiated terms or terms supplied by Article] in the agreement between them.

Fourth, the purpose of §2-207 is [in all drafts] 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," §1-201(42), and "standard terms," §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 §2-207 arises [in all drafts] because the party against whom the standard terms operate has apparently agreed to them by conduct [not "manifested assent", §2-102(a)(29)] under circumstances where there is no realistic opportunity to review the record. Unlike the §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, in the July, 1996 Draft, more than a simple awareness of the standard terms was 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).

At the November, 1996 meeting of the Drafting Committee, however, the decision was made to delete any rules responding to standard forms and standard terms in commercial transactions. Thus, 2-206(a) was withdrawn and a redraft of 2-207 that used the words "records" and "terms" rather than "standard forms" and "standard terms" was approved in principle. The January, 1997 Draft, however, retained [standard terms] bracketed for testing purposes and contained a subsection (c) proposing a "clean up" rule where one party claims that standard terms in a record were incorporated by express agreement. At the January, 1997 meeting of the Drafting Committee, the Reporter was directed to delete all references to standard terms in and subsection (c) to 2-207.

(2) The March, 1997 Draft of 2-207.

The title now reads: "Terms of the Contract; Effect of Varying Terms.

the special rules for consumer contracts, 2-206, and the parol evidence rule. 2-202.

The section deals with two special cases where disputes over terms may arise, (1) where both parties exchange records (herein of the "battle of the records ") and (2) where one

party uses a record to confirm a contract previously formed, and states what terms are included in, and by necessary implication excluded from, the contract. Thus, terms upon which the records agree in substance are included but terms upon which the records do not agree are excluded, unless they are “otherwise agreed to or become part of a modification under 2-210(a). But the “otherwise agreed to” principle is subject to an exception: The court may find, after reviewing the transaction, that a term in a record to which one party apparently assented should be excluded because that party would be unfairly surprised or suffer hardship if the term were included.

A primary purpose of original 2-207 and the interpretive cases was to police against unfair surprise in commercial transactions. The risk of unfair surprise is high when one party attempts to include a standard term (“boilerplate”) drafted to serve its own interest in a contract where the other party appears to agree by conduct or otherwise but did not read and was not expected to read the term. These terms are frequently excluded by the courts unless the other party assented with express awareness of or expressly agreed to them. Although the Drafting Committee, because of definitional problems, has not relied upon the presence of “standard terms” or imposed a requirement of “expressly agreed to” in the statute, the process of contract formation here is still subject to the unconscionability limitation in 2-106, which deals with unfair surprise and hardship. It is expected that courts interpreting revised 2-207 will continue to find unfair surprise where the circumstances warrant and exclude terms not clearly covered by 2-207 unless there is express agreement to them. The lesson from the case law is that it is much easier for a court to find unfair surprise or the presence of express agreement after the fact than it is to state those principles in the statute. Thus, 2-207(3) states the exclusionary principle in broad terms and relies upon the courts to apply it.

Revised Section 2-207: A Road Map.

Assume that some contract has been formed. What are its terms?

(a) All terms are expressed in one record.

For consumer contracts, see 2-206. For commercial contracts, the usual principles of agreement apply.

(b) No terms are expressed in a record.

Does the statute of frauds apply? See 2-201. If not, for all contracts the usual principles of agreement apply.

(c) Some Terms in the Record of only one party.

Here the parties have concluded a contract and some (not all) of the terms are in the record of one party.

Assuming that the statute of frauds and the parol evidence rule have been satisfied, the usual principles of agreement, limited by 2-105, apply.

Suppose the offer is made in a record and is accepted orally or by conduct. The assumption is that all of the terms in the record (offer) are part of the contract (the offeree agreed to them) unless the court finds unfair surprise under 2-105. Without the 2-106 possibility, the

“first shot is alive and well.

Suppose the offer is oral and the acceptance (definite and seasonable) is in a record that contains additional or different terms. Without more, there is a contract and the varying terms are proposals to modify the contract. They are excluded unless agreed to by the other party. What is agreement here? Since 2-207 does not apply, there are no special rules. Thus, if the varying terms are standard terms to which there was no express agreement (only assent by conduct), the court must decide whether the claimed inclusion is unconscionable, 2-105, or, perhaps, apply 2-207(3) by analogy.

Can one assume that these cases, i.e., where there is only one record but there is a contract, are rare?

(d) Both parties exchange records.

Here the terms of the contract are determined by the primary rule of 2-207(1). Thus, if the seller seeks to include a term in its record and the buyer also has a record, the seller's term is out unless the records of the parties agree in substance. They would not agree unless both parties had a term on the same matter, e.g., notice time for breach of warranty, and the terms agreed in substance, e.g., 20 days vs. 18 days. This is the exclusionary rule in current 2-207(3) and Article 2.22 of the UNIDROIT Principles, except that the “knock out” does not depend upon standard terms. Hence, revised 2-207 deals with the “battle of the records.”

(e) Confirmations.

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

Original §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 §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 §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.

The November, 1996 Draft solved the problem as follows:

First, the statute of frauds was repealed. [The statute of frauds is now reinstated.]

Second, whether the oral or informal agreement was a contract was decided under §§2-203 and 2-205. [This remains the same.]

Third, if there was a contract whether the terms in the standard form confirmation become part of the agreement depended upon 2-207(a)(3): The terms were not included unless the other party expressly agreed to them.

Fourth, if the record proposes a modification and the terms are included under

§2-207(a)(3), whether the modification is enforceable is determined by §2-210(a).

Finally, whether the record is a repudiation rather than a proposed modification is determined by §2-713.

The March, 1997 draft assumes that a contract has been formed and that the statute of frauds has been satisfied. Thus, 2-207(2) states that if “one party has confirmed a contract by a record, the terms of the contract are those terms...that do not materially vary the contract and are not objected to in a timely manner. Thus, terms that materially vary the contract are excluded and may constitute a repudiation. If not a repudiation, they are proposals for modification of the contract which may be accepted by agreement under 2-210(a).

SECTION 2-208. ELECTRONIC TRANSACTIONS: FORMATION.

(a) If an electronic message initiated by a party or electronic agent evokes an electronic response and the message and response reflect or are attributed with the intent to be bound, a contract exists when:

(1) the response is received if the response consists of furnishing the requested information or notice of access to the information and the originating message did not prohibit that form of response; or

(2) the sender of the originating message receives an electronic message signifying acceptance.

(b) In an electronic transaction, the following rules apply:

(1) A contract is formed although no individual representing either party was aware of or reviewed the initial message, response, reply, information, or action signifying acceptance.

(2) An electronic message is effective when received even if no individual is aware of its receipt.

(c) In an electronic transaction involving an interaction between two electronic agents or an interaction between an individual and an electronic agent, the following rules apply:

(1) If two electronic agents interact, a contract is formed if the interaction results in both agents engaging in further actions that signify a contract, such as by engaging in performance, ordering or instructing performance, or making a record of the existence of a

contract.

(2) If there is an interaction between an individual and an electronic agent of another party and the individual has reason to know that the individual is dealing with an electronic agent, a contract is formed when the individual performs actions the individual should know will cause the agent to perform or to permit further use, or that are clearly indicated as constituting acceptance.

(3) the terms of the contract include terms on which the parties have previously agreed, terms which the electronic agents could take into account, and, terms provided by this article or other law.

Notes

Section 2-208 follows 2B-206 and 2B-205(e) (Dec. 12, 1996)

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

(a) If an 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 whenever reasonable as consistent with each other. However, if that construction is unreasonable:

(1) express terms prevail over course of performance, course of dealing, and usage of trade;

(2) course of performance prevails over course of dealing and usage of trade; and

(3) course of dealing prevails over 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 2-208.

Notes

This Section has been conformed to 2B-302 (Sept. 1996). It is probable that 2-209, as conformed, **will be moved to Article 1. See 1-304(a) (1997). If so, a drafting strategy may be to move 2-209 to the end of Part 2 so that section renumbering can be avoided.**

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

(a) An agreement made in good faith which modifies a contract under this article is binding without consideration.

(b) The agreement modifying a contract under subsection (a) may be binding even if the requirements of the [statute of frauds] are not satisfied. However, the contract as modified must satisfy [the statute of frauds].

(c) Except in a consumer contract, an authenticated record that contains a term prohibiting modification or rescission except by an authenticated record may not be otherwise modified or rescinded. However, a party whose language or conduct is inconsistent with the term may not assert the term if the language or conduct induced the other party to change its position reasonably and in good faith.

(d) Except as otherwise provided in subsection (c), a contractual term that is not part of the agreed performance may be waived. Language or a course of performance between the parties is relevant to show a waiver by one party 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.

Notes

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

First, the requirement of an agreement made in good faith 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 §1-203. This revision is rejected in 2B-303.

Second, subsection (b) is revised to reflect the reinstatement of the statute of frauds. It is now clearer that an oral modification may be binding without satisfying the statute but that the contract as modified must satisfy the statute. Thus, if neither the contract nor the modification are within the statute (both are below the \$10,000 threshold) but the contract as modified is (price now \$15,000), 2-201 must be satisfied. Further, if the contract is within and satisfies the statute and there is an oral modification that increases the quantity and the price, the contract as modified is within the statute. Has it been satisfied? Under revised 2-201(a), the answer is yes to the price term and no to the quantity term. The contract is not enforceable beyond the quantity term stated in the record.

This subsection adopts the analysis in *Costco Wholesale Corp. v. Worldwide Licensing*, 898 P.2d 347 (Wash.App. 1995).

Third, except in a consumer contract the parties may agree in an authenticated record that an authenticated record is required to modify or rescind. The parties may create their own statute of frauds. The only way to avoid this limitation other than by compliance is by the estoppel test stated in subsection (c). In short, the party seeking to invoke the NOM clause may be estopped if inconsistent language or conduct have induced reasonable, good faith reliance. See *Brookside Farms v. Mama Rizzo's, Inc.*, 873 F. Supp. 1029 (S.D. Tex. 1995). This result is consistent with the estoppel exception built into revised 2-201(3).

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.

(2) Subsection (d) recognizes the general principle of waiver where NOM clauses are not involved. Terms that are not part of the agreed exchange of performances (the "consideration") may be waived by one party without agreement by the other. These terms will normally be express conditions upon an agreed or promised performance.

There are three types of waiver. 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).

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 (b) 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 §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. Compare 2-604 and 2-702.

SECTION 2-211. ELECTRONIC TRANSACTIONS; ATTRIBUTION

PROCEDURE.

(a) A procedure established by agreement or adopted by the parties for the purpose of verifying that electronic records, messages, or performances are those of the respective parties or for detecting errors in the transmission or the information content of an electronic message, record, or performance, constitutes an attribution procedure if the procedure is commercially reasonable.

(b) Whether an attribution procedure is commercially reasonable is a question of law to be determined by the court in light of the purposes of the procedure and the commercial circumstances at the time of the agreement, including the nature of the transaction, volume of similar transactions engaged in by either or both of the parties, availability of alternatives offered to but rejected by the party, and procedures in general use for similar types of transactions. An attribution procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, key escrow, or similar security devices that are reasonable under the circumstances.

(c) Except as otherwise provided in Section 2-212, if a loss occurs because a party

complies with a procedure that was not commercially reasonable, the party that proposed or required use of the procedure bears the loss unless it disclosed the nature of the risk to the other party or offered commercially reasonable alternatives that the party rejected.

Notes

Section 2-212 follows 2B-110 (Dec. 1996).

SECTION 2-212. ATTRIBUTION OF ELECTRONIC RECORD, MESSAGE, OR PERFORMANCE; ELECTRONIC AGENT.

Notes

1. Section 2-212 will follow 2B-111 (January, 1997) which is still under consideration by the Article 2B Drafting Committee.

What parts of this complex and evolving section are unique to licenses?

2. Section 2-211 (July, 1996), dealing with “delegation of performance, has been moved to Section 2-503.

PART 3

GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

SECTION 2-301. HOW CONTRACT PRICE PAYABLE.

(a) The contract price may be made payable in money or otherwise.

(b) If the contract price is payable in whole or in part in goods, each transferor is a seller for the purposes of this article with respect to the goods transferred.

(c) The sale of goods is subject to this article even if all or part of the contract price is payable in an interest in real property. This article applies to the transfer of goods but not to the transfer of an interest in real property.

SOURCE: Sales, Section 2-304.

Notes

There are no substantive changes in former §2-304.

SECTION 2-302. TRANSFER AT SINGLE TIME.

(a) If all of a party's performance can be rendered at one time, the performance is due at one time and the other party's 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.

(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 full performance.

SOURCE: Sales, Section 2-307.

Notes

1. This is an elaboration of former §2-307 and clarifies when a party's performance is due at one time and what the other party's duties are on full performance. Subsection (a) follows 2B-603. Subsections (b) and (c), which state when, in the absence of an agreed installment contract, a part performance is permitted and how payment is to be apportioned, follow 2B-604. Except for covering the obligations of both seller and buyer, no changes of substance are intended. See 2-610(a) and 2-611(a) on who, seller or buyer, must tender first.

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 §2-716, 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 §2-302 creates an installment contract, i.e., goods delivered "in separate lots to be separately accepted." §2-711(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 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 §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 PRICE TERM.

(a) The parties, if they so intend, may form a contract for sale even if the price is:

(1) not agreed to;

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

(3) 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) The price of a contract formed under subsection (a) is a reasonable price at the time that the seller is to complete its initial delivery.

(c) A price to be fixed by the seller or the buyer must be fixed in good faith.

(d) If a 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.

(e) If the parties intend not to be bound unless the contract price is fixed or agreed to and it is not fixed or agreed to, a contract is not formed. 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, and the seller shall return any portion of the contract price paid on account.

SOURCE: Sales, Section 2-305.

Notes

1. There are no substantive revisions in former §2-305.

2. Section 2B-305 on “open terms” provides a structure and approach to a variety of open terms, including price. Should an effort be made to conform 2-303 and other “gap fillers” in Article 2 to the form and structure of Article 2B?

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

(a) A contractual 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 that may occur in good faith. If actual output or requirements occur in good faith, a seller may not offer or a buyer may not demand any quantity unreasonably disproportionate to any stated estimate or, in the

absence of a stated estimate, to any normal or otherwise comparable previous output or requirements.

(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.

SOURCE: Sales, Section 2-306.

Notes

1. Section 2-304(a), which conforms in substance to 2B-306(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 §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," §2-304(a) does not apply. See *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W. 2d 759 (Tex. 1996)(good faith increases in output subject to "take or pay" provision).

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 require that there must 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 extreme position is rejected. 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); Restatement (Second) Contracts sec. 79(c)(where consideration requirement is met there is no additional requirement of mutuality of obligation). 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 was an exclusive dealing contract. §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 §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 §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, §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 the size of the variations and whether they 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).

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. Unlike 2B-306(c) & (d), no effort is made in this Draft to state a standard for "best efforts."

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 place other than that described in subsection (a), that place is the place for their delivery.

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

SOURCE: Sales, Section 2-308.

Notes

There are no revisions of substance in former §2-308. See 2B-203(b).

SECTION 2-306. TIME FOR PERFORMANCE NOT SPECIFIED.

(a) Except as otherwise expressly provided in this article, the time for performance or any other action under an agreement in which a time for performance is not specified is a

reasonable time.

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

SOURCE: Sales, Section 2-309(1) and (2).

Notes

1. Section 2-306 adopts without change the provisions for time and duration of performance found in §2-309(a) & (b) of the December, 1994 Draft. Termination of the contract, previously covered in §2-309(c), is now covered in §2-311. This conforms in substance to 2B-315.

2. The basic "gap filler" for time is a "reasonable time," defined in §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." §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 §2-311(a).

SECTION 2-307. OPTIONS AND COOPERATION RESPECTING PERFORMANCE.

(a) An agreement that is otherwise sufficiently definite to be a contract is enforceable even if 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 of commercial reasonableness.

(c) An agreement 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 an 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 seller's option.

(e) If a specification by one party would materially affect the other party's performance

but 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 own 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 of contract.

SOURCE: Sales, Section 2-311.

SECTION 2-308. FAILURE TO PAY BY AGREED 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 an agreed 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) In this section "confirmed letter of credit" means a letter of credit that carries the direct obligation of a confirmed or financing agency of good repute or, if the shipment is overseas, of good international repute that issues an irrevocable letter of credit.

SOURCE: Sales, Section 2-325.

Notes

Section 2-308, formerly §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 §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 trade and any course of performance or course of dealing between the parties. If any applicable usage of trade, course of performance, or course of dealing is not shown, the meaning of shipment terms used in an agreement may be interpreted by reference to

the Incoterms published by the International Chamber of Commerce.

SOURCE: Sales, Sections 2-319, 2-320, 2-321, 2-322, 2-324.

Notes

1. In the May, 1994 Draft, §§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.

2. 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. Nevertheless, some definition of delivery terms for revised Article 2 might still be required.

3. Professor Mark Roszkowski has made suggestions for incorporating shipping terms based on *Incoterms 1990* into revised Article 2. The revision starts with 2-309A, which consolidates obligations imposed on the seller under all terms and then arranges 13 shipping terms containing more specific obligations into four categories, (1) departure terms, e.g., “ex works, (2) main carriage unpaid terms, e.g., FAS or FOB, (3) main carriage paid terms, e.g., C&F or CIF, and (4) arrival terms, e.g., “delivered at frontier or “delivered ex ship. The draft is over 31 pages, including conforming amendments.

Policy question: Should some or all of these terms be included in Revised Article 2?

SECTION 2-310. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in 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 a previous breach or performance of the contract;

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

(3) an obligation to return or dispose of goods, which obligation must be promptly performed;

(4) a choice of law or forum ;

(5) an obligation to arbitrate or otherwise resolve disputes through alternative dispute resolution procedures;

(6) a term limiting the time for commencing an action or for providing notice;

(7) an indemnity provision; and

(8) any right, remedy, or obligation stated in the agreement as surviving.

SOURCE: Licenses, Section 2B-617.

Notes

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

2. Section 2-310 has been conformed to 2B-626 (January, 1997).

SECTION 2-311. TERMINATION; NOTIFICATION.

(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) A term dispensing with notification is invalid if its operation is unconscionable.

However, an agreement specifying standards for the nature and timing of notification is enforceable if the standards are not manifestly unreasonable.

SOURCE: Sales, Section 2-309(3).

Notes

1. Assuming that a party has power to terminate the contract, §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 §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." §1-204(2). This differs from the September, 1996 draft of 2B-629(a), which states that the party terminating the contract must send reasonable notice of termination. Article 2B has been requested to conform to Article 2 on this.

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." Compare 1-105, which ties unconscionability to the time of contracting.

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, §1-203, which cannot be disclaimed by agreement. §1-102(3). Many 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.

SECTION 2-312. 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 another customary manner. If a bid is made during the process of completing the sale but before a previous bid is accepted, the auctioneer may in its discretion reopen the bidding or declare the goods sold under the previous bid.

(c) A sale by auction is with reserve unless at the time the goods are put up or during the course of the auction it is announced in express terms that the sale is 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 authority 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 2-328.

Notes

No major revisions are proposed in former §2-318. There are relatively few cases and they reveal no significant 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).

1. In subsection (a), in a “sale by auction” the auctioneer “invites price offers from successive bidders which he may accept or reject.” Restatement (Second) Contracts sec. 28(1).

Although not specifically stated, an auctioneer can condition delivery upon payment for all goods sold, even if the sale is in separate lots. If each lot is a separate sale, bidders who arrive late are on constructive notice of the terms of later sales. Restatement, (Second) Contracts sec. 28(2).

2. In subsection (b), the quaint phrase “fall of the hammer” is preserved, although a more inclusive phrase is “announcement of completion of the sale.”

The “prior bid” problem can occur when the sale is “with reserve,” the default rule. 2-320(c). Subsection (b) supports a limited extension of the auctioneer’s discretion beyond the time when the sale was completed.

3. Under subsection (c), in a sale “with reserve” (the default rule), the auctioneer invites bids (offers) and reserves the power to accept or reject them. Bidders assume the risk that the goods will be withdrawn before the sale is concluded. The contract is concluded, however, when the completion of the sale is announced. See *Sly v. First Nat’l Bank of Scottsboro*, 387 So.2d 198 (Ala. 1980); Restatement 2d, Contracts secs. 26, 28, Comment b.

If the sale is in “explicit terms...without reserve,” when and where is the contract formed? Clearly, a final deal is not struck until a some bid is made within a reasonable time and not withdrawn before the auctioneer announces the completion of the sale. Both parties have some discretion (the auctioneer’s is more limited) after the bid is made. This supports the conclusion that the contract is formed at the place where the auctioneer is located, rather than at the point where the bid is made, whether made by mail or through EDI.

Suppose, during the course of a “with reserve” auction, the auctioneer announces that the sale is now “without reserve.” Original 2-328(3) did not recognize this conversion possibility, which (we are told) exists in practice. Such a conversion, in effect, announces a “reserve bid” in that the goods will not be sold below the last bid before the conversion. Does modern auction practice support the underlined language added to subsection (c) above? Suppose a sale “without reserve” is converted to a sale “with reserve” during the course of the auction? For a case holding that the goods were not in “explicit terms” put up without reserve where the auctioneer stated that there was no minimum bid and the goods would be sold to the highest bidder, see *Miami Aviation Serv. v. Greyhound Leasing & Finance Corp.*, 856 F.2d 166 (11th Cir. 1988).

Subsection (c) does not deal with the so-called conditional sale, where final approval after the sale is concluded is reserved to the seller, a secured party or a court. These conditions are enforced by the courts. *Lawrence Paper Co. v. Rosen & Co.*, 939 F.2d 376 (6th Cir. 1991). Language dealing with the “conditional sale, a third method of sale by auction, has not been added.

4. In a sale with reserve, the power of the seller to withdraw the goods at any time should be distinguished from bids by the seller without proper notice. The latter problem, which raises questions of rigged or fraudulent bidding, is addressed in subsection (d). See *Vanier v. Ponsoldt*, 833 P.2d 949 (Kan. 1992)(bid rigging).

Although subsection (d) is silent, the courts have required a bidder to take action to avoid the sale or take the goods at the last good faith bid within a reasonable time after he discovered or should have discovered the operative facts. Should language like this be added to subsection (d)?

The last sentence states that subsection (d) does not apply to a “forced sale. To avoid conflicts with auction sales under Article 9 and 2-819(c), should it be limited to public auctions under or required by legal process? If so, subsection (d) would then apply to auctions that enforce security interests or implement the resale remedy for breach of contract.

5. The following coordination needs or conflict resolution with other provisions in Revised Article 2 still need to be resolved.

2-402(a). When must the auctioneer disclose the name of the principal to avoid liability as a seller? In auctions where hundreds of sellers are involved or goods on consignment arrive just before sale, practical problems are posed if disclosure must be just before the bidding. But if not then, when? The current 2-402(a) states that the auctioneer must state that it is acting on behalf of a principal, not disclose the identity of the principal.

2-407(c). According to one commentator, this section as written would cause “catastrophic changes in the auction industry. The argument is that since most auction warranties auction sale unworkable. One solution is to except auctions from the definition of “consumer contract. Another is to provide a “safe harbor for the “as is disclaimer at auctions.

2-409(a). Clarify when the definition of seller used in 2-401(a) is the same as that used in other sections, such as 2-312.

2-506. Should auctioneers should be excluded from the “sale or return provisions?

2-819. Possible conflicts between 2-312 and 2-819 on notice requirements in resales by auction should be resolved. Arguably, the more specific requirements for resale as a remedy for breach should control over 2-312.

These questions have not been resolved in this Draft.

PART 4.

WARRANTIES

SECTION 2-401. DEFINITIONS. In this part:

(1) "Damage" means all loss resulting in the ordinary course from a breach of warranty, including injury to a person or property.

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

(3) "Immediate buyer" means a buyer in a contractual relationship with the seller.

(4) "Remote buyer" means a buyer or lessee from a person in the chain of distribution other than the seller against which a claim for breach of warranty breach is asserted.

**SECTION 2-402. 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 that fails to disclose that it is acting on behalf of a principal, that:

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

(2) the goods will be received 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 disclaimed or modified only by express 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 disclaim 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) A seller that 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 that furnishes specifications to the seller holds the seller harmless against any claim of infringement or the like 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

or transferee that may reasonably be expected to buy the goods and that suffers damage from breach of the warranty. The rights and remedies of a remote buyer or transferee 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 by article.

(e) A right of action for breach of warranty under this section accrues under Section 2-814(b) when the buyer discovers or should have discovered the breach.

SOURCE: Sales, Section 2-312.

Notes

1. Subsection (a) defines seller to include an "auctioneer or liquidator who fails to disclose that it is acting on behalf of a 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 before or at the time of the auction. An auctioneer who does not disclose its principal may, however, disclaim the warranty of title under subsection (b).

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. Without more, the statute of limitations for breach of warranty under subsection (a) runs from when the cause of action accrues under §2-814(a). 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 is implemented in subsection (e). Section 2-814, however, still governs all other statute of limitations issues.

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 §2-408(c).

5. In March, 1995 meeting, the Drafting Committee concluded that (1) the disclaimer provisions in subsections (b) and (c) should be retained in §2-402 rather than moved to §2-408, and (2) no special protection for consumer buyers was needed in light of the new provision governing standard form records. §2-206. At the September, 1996 meeting, it was argued that the word "notice" should be substituted for "knowledge" in subsection (a)(2). Since notice is a broader concept, this might narrow the scope of the warranty against liens or encumbrances. No action was taken.

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 or transferee. See 2-409(a). 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 §2-401(definitions) and §2-410(a). Moreover, a remote buyer's claim against the seller must be brought within four years after the cause of action is should be discovered. 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 2-403. EXPRESS WARRANTY TO IMMEDIATE BUYER.

(a) If a seller describes the goods, makes an affirmation of fact that relates to the goods, provides a sample or model, or makes a promise to an immediate buyer, the description, affirmation, sample, model, or promise becomes part of the agreement with the immediate buyer unless a reasonable person in the position of the immediate buyer would believe otherwise or would believe that the affirmation was merely of the value of the goods or purported to be merely the seller's commendation of the goods.

(b) If a description, affirmation, sample, model, or promise becomes part of the agreement, the seller has an obligation to the immediate buyer that the goods will conform to the description, affirmation, or model, that the whole of the goods will conform to the sample or that the promised performance will be provided. The obligation is breached if the goods do not conform to any description, affirmation, sample, or model at tender of delivery [the time the risk of loss passes to the immediate buyer] or if the promised performance is not given when due.

(c) A seller's obligation to the immediate buyer under this section may be created:

(1) in a medium for communication to the public, including advertising;

(2) even though the seller does not use formal words, such as "warranty or

"guaranty.

SOURCE: Sales, Section 2-313.

Notes

Section 2-403 deals with express warranties in a direct contractual relationship between seller and immediate buyer. It is intended to supplement rather than supplant other provisions dealing with contract formation and the scope of an agreement. **There are no changes of substance in 2-403 since the January, 1997 meeting. To clarify the point, a separate state of "description of the goods" is added.**

1. Subsection (a) states the general principles applicable where an "immediate" buyer claims a breach of express warranty by the seller. It follows §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 clarifies that an express warranty is treated like any other term of the agreement and that the buyer need not initially prove reliance to include it in the agreement.

Subsection (a) also 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 usual assumption is that they become part of the agreement unless the seller establishes "otherwise." This is consistent with the comments to §2-313 of the 1990 Official Text and most of the interpretive case law. This "presumption", however, is not stated in the statute.

One question is whether a reasonable person in the position of the buyer would 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 another's skill and judgment, the exception would be satisfied.

A second question is whether what was affirmed or said about the goods was puffing. Put differently, was the language opinion, commendation or a general valuation rather than an affirmation of fact or promise? If so there is a probable "puffing" 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).

3. Subsection (b)(1) clarifies that an express warranty in a direct contractual relationship may be created by communications to the public, including advertising.

Subsection (b)(2) is taken without change from the first clause in §2-313(2) of the 1990 Official Text.

4. A warranty, express or implied, is breached if the goods do not conform when the seller tenders delivery. See 2-814(c)(1). Thus, if the seller expressly warranted that the goods were new (establishing the standard to which the goods must conform) and used goods were tendered, there is a breach of warranty.

CISG Art. 36(1), however, provides that the seller is liable for any "lack of conformity which exists when the risk passes to the buyer, even though the lack of conformity becomes apparent after that time. It has been suggested that the time the risk passes should be adopted by revised Article 2. This might work if risk passes upon tender of delivery regardless of whether the seller was in breach. This is not the case under revised 2-612.

SECTION 2-404. EXPRESS WARRANTY OBLIGATIONS TO REMOTE PURCHASERS AND TRANSFEREES ARISING OTHER THAN AS PART OF AGREEMENT OF SALE.

(a) If a seller makes an affirmation of fact that describes or relates to new goods or a promise, on or in a container, on a label, or in a record that is otherwise packaged with the goods, and the seller authorizes another person that is not an agent of the seller to deliver the container, label, or record to a remote buyer of those goods and they are so delivered, the seller has an obligation to the remote buyer and its transferee that the goods will conform to the affirmation or that the promised performance will be performed, unless a reasonable person in the position of the remote buyer would believe otherwise or would believe that an affirmation was merely of the value of the goods or purported to be merely the seller's recommendation of the goods.

(b) If a seller makes an affirmation of fact that describes or relates to the goods, provides a sample or model, or makes a promise in a medium for communication to the public, including advertising, and a remote buyer with knowledge of the affirmation, sample, model, or promise buys or leases new goods from a person in the chain of distribution, the seller has an obligation to

the remote buyer and its transferee that the goods will conform to the affirmation or model, that the whole of the goods will conform to the sample, or that the promised performance will be provided, unless a reasonable person in the position of the remote buyer would believe otherwise or believe that the affirmation was merely of the value of the goods or purported to be merely the seller's commendation of the goods.

(c) An obligation may be created under this section even though the seller does not use formal words, such as "warranty" or "guaranty."

(d) An obligation arising under this section is breached if the goods do not conform to any affirmation, sample, or model at the time the goods are received by the remote buyer, or if the promised performance is not given when due.

(e) If an obligation created under this section is breached, remedies of a remote buyer and its transferee against the seller are determined by this article, to the extent appropriate in the circumstances, subject to the following rules:

(1) A remote buyer and its transferee is subject to any valid limitations on rights or remedies in or on the container, label, or record or contained in the medium of communication to the public that created the obligation.

(2) The remedies of rejection and revocation of acceptance are not available.

(3) Subject to subsection (e)(1), the remote buyer and its transferee may recover damages for the loss resulting in the ordinary course from the breach, together with incidental and consequential damages, less expenses and costs avoided as a result of the breach. However, a remote buyer and its transferee under subsection (b) may not recover consequential lost profits.

(4) The period of limitations in Section 2-814 begins to run when a breach of obligation occurs under subsection (d).

(f) This section is subject to section 2-409(b).

SOURCE: New.

Notes

Section 2-404, dealing with express warranties to remote purchasers and transferees, combines Sections 2-404 and 2-405 in the November, 1996 Draft. It is not intended to limit the judicial development of broader grounds for imposing liability on a seller to a remote purchaser. See 2-409(b)(2).

Section 2-404(a) “Pass through warranties.

(a) New Section 2-404(a) deals specifically with the “pass through warranty, including the “warranty in the box, made by a seller (usually a manufacturer) to remote purchasers and their transferees through an authorized intermediary (usually a retailer in the chain of distribution) who is not an agent of the seller.

If the intermediary is an agent of the seller, 2-403 applies. Other cases where 2-403 should apply include those where there is direct dealing between the seller and buyer through an intermediary or where the manufacturer makes an offer to the public (if you buy and use this product, the following will occur...) and individuals accept the offer by purchasing the goods from a retailer.

The warranty is made to a remote purchaser, defined in 2-401(4), and extended to a transferee of the purchaser, who is sheltered. The transferees rights are dependent upon the rights of the remote purchaser.

The obligation created is independent of any contract between the remote purchaser and the intermediary retailer. The terms of that contract may differ from the obligation created under subsection (a).

(b) Subsection (a) states when the seller’s obligation to the remote purchaser is created. The obligation arises when the goods are delivered to or received by the remote purchaser whether or not the purchaser has knowledge of the terms. Nevertheless, the alleged affirmations or promises do not create an obligation if a reasonable person in the position of the remote purchase would believe that a promise was not made or the affirmation was puffing. This follows the exclusionary language of 2-403(b).

Common situations where subsection (a) applies include warranties made on goods or in a record contained in a box (including “shrink wrapped products), warranties made on the goods or on labels or records accompanying the product and warranties in literature delivered before, at or after delivery of the goods. Since a direct obligation is imposed upon the seller, it is irrelevant that the affirmations or promises were made after the remote purchaser paid for and took delivery of the goods from the retailer. The phrase “otherwise packaged with the product signals an expansive interpretation of this subsection.

(c) The assumption underlying subsection (a) is that the seller has no other warranty (or contractual) obligation to the remote purchaser. Thus, the seller should be able to define what affirmations or promises are made with the understanding that no implied warranties are created. In short, there is no need to disclaim that which does not exist.

Suppose, however, that the affirmation or promise also attempts to limit the time within which claim may be asserted or to limit a remedy for breach. Should these limitations be part of the obligation created? Under subsection (e)(1), the answer is yes if these limitations are valid. This approach raises two questions which this draft does not clearly answer and which the Drafting Committee should resolve.

First, should the remote purchaser be bound by the limitations simply because he elected to enforce the obligation created under subsection (a)? The implicit answer is yes. The policy question, however, is whether the remote purchaser should have a opportunity to review the limitations (to avoid surprise) before they are effective? Put differently, does the “manifest assent requirement in a “mass market transaction, see 2B-308, make sense here? For example, in two recent cases, *Olathe Mfg. v. Browning Mfg.*, 915 P.2d 86 (Kan. 1996) and *Hornberger v. GMC*, 929 F. Supp. 884 (E.D. Pa. 1996), the courts concluded that a buyer who received a “pass through warranty was not bound by limitations on that warranty or remedies that were not communicated at the time of contracting.

Second, when is a limitation invalid if the remote purchaser, with an opportunity to review, attempts to enforce the obligation? The answer: Hardly ever, unless there are some special concerns in the non-contractual relationship. No special rules for this situation are now provided in revised Article 2.

2. Section 2-404(b). Express warranties to the public.

New Section 2-404(b) deals with warranty obligations arising from communications to the public. In essence, when a remote purchaser with knowledge of an affirmation of fact or promise made by the seller to the public purchases the goods from a seller or lessor in the chain of distribution, the seller making the affirmation or promise has an obligation to the remote buyer if the goods fail to conform unless the remote buyer or lessee, as a reasonable person, would believe that no promise was made or that the affirmation was puffing. On the puffing question, the factors relevant to the question under 2-403 also apply to 2-404(b).

After discussion, the Drafting Committee defeated a motion to delete the word “knowledge at the September, 1996 meeting. Unlike the pass through warranty in subsection (a), the remote purchaser must have knowledge of the affirmation or promise at the time of purchase.

Illustrations:

1. Seller advertises its product in trade journals, on the internet and on TV. Buyer buys the goods from the seller, directly or through an agent. Whether the advertisement is an express warranty and part of the agreement is determined under 2-403.
2. Seller advertises as in #1 and Buyer purchases directly from Seller, ordering by Fax and paying by credit card before the goods arrive. The goods arrive in a box which contains additional warranties and terms limiting remedies. This is not a pass through warranty under 2-404(a). Rather, 2-403 applies to the warranty issues and other provisions of Article 2 govern whether the terms in the box are part of the agreement. [This is *Hill v. Gateway Computer.*]
3. Seller advertises as in #1 and Buyer purchases the goods from a retailer. In the box are warranties and limitations prepared by Seller, which Retailer was authorized to deliver to B. Since there is no contractual relationship between B and S, 2-404(a) determines the status of the terms in the box and 2-404(b) determines the status of the advertising.
4. Seller advertises as in #1 and Buyer purchases from a Retailer. There are no pass through warranties. The status of the advertising is determined by 2-404(b). Neither 2-403 nor 2-404(a) apply.

5. S advertises as in #1. Aware of the advertising, which is general, B asked Retailer whether S's product will meet a required specification. When R did not know, B contacted S directly and asked. S responded in a letter that the described goods would meet the specifications and B then purchased the goods from R. If the goods fail to meet the specification, B's claim against S should be resolved under subsection (b). But (b) seems to require advertising to the public and this was a representation made directly to B. Nevertheless, the liability case is strong and the claim should be enforced under subsection (b). But see *Vermont Plastics, Inc. v. Brine, Inc.*, 79 F.3d 272 (2d Cir. 1996), holding that Vermont does not recognize such a claim.

3. Remedies.

What remedies are available to a remote purchaser when the seller breaches an obligation created under 2-404? There is no direct contractual relationship between the parties. Should the remote purchaser have all of the remedies that would be available against their immediate seller or lessor?

The answer is no. The remote purchaser gets the usual Article 2 remedies if "appropriate in the circumstances" and not otherwise limited in subsection (c).

First, subsection (e)(1) deals with the downside in the "pass through" or advertising warranty under subsections (a) and (b): If the buyer seeks to enforce the warranty given it is bound by valid (enforceable) limitations on rights and remedies attached to the rights as determined under Article 2.

Second, subsection (e)(2) precludes the remote plaintiff from rejecting the goods or revoking acceptance against the seller or pursuing any remedies consistent with rejection or revocation. Thus, the remote party cannot recover the price paid to the immediate seller from the seller under subsections (a) and (b) and can't measure damages by "cover" or the contract price-market price formula. Those remedies, however, are available against the immediate seller.

Third, subsection (e)(3) of the January, 1997 Draft treated the goods as accepted for purposes of notice and burden of proof. Thus, the remote party was required to give the seller notice as required by 2-708(c)(1) and establish that the goods did not conform to the warranty under 2-708(d). **Subsection (e)(3) was deleted by the Drafting Committee at the January, 1997 meeting.**

Fourth, subsection (e)(3) states the basic measure of damages in 2-404 cases. See 2-804(1), 2-827(b). Compare 2-409(a).

Consequential damages, as limited by 2-806, are recoverable with two exceptions: (1) A valid exclusion clause under subsection (e)(1), or (2) the recovery of lost profits by a remote purchaser under 2-404(b). A remote purchaser under subsection (a), however, may recover lost profits if not validly excluded. [**Drafting Committee, January, 1997**]

Why this distinction between "pass through" remedies and advertising remedies?

Fifth, the four year limitation period in 2-814(a) begins to run when the breach of obligation occurs under 2-404(d), i.e., when the nonconforming goods are received or when the promise was not performed when due.

[Many of the problems addressed in 2-404 were raised in *Sullivan v. Young Bros. & Co., Inc.*, 893 F. Supp. 1148 (D. Me. 1995), aff'd, 91 F.3d 242 (1st Cir. 1996)(Maine version of 2-318(c)).]

SECTION 2-405. IMPLIED WARRANTY OF MERCHANTABILITY; USAGE OF TRADE.

(a) Subject to Section 2-407, 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 made on the container or label.

(c) Subject to Section 2-408, implied warranties other than those described in this section may arise from course of dealing or usage of trade.

SOURCE: Sales, Section 2-314.

Notes

1. Section 2-405(b)(3) has been revised to state that merchantable goods must be fit for the ordinary purposes for which “goods of that description” are used. This is more accurate historically and gives sharper guidance to courts working with the standard. It also follows CISG Art. 35(2), which states that “Except where the parties have agreed otherwise, the goods do not conform to the contract unless they: (a) are fit for the purposes for which such goods of the same description would ordinarily be used.”

2. 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 §2-314(b) or the evolving law of products liability. See Restatement of the Law Torts: Products Liability §2, comment (g).

3. Privity. Under revised Article 2, an implied warranty of merchantability is made only to an immediate buyer unless three exceptions are satisfied: (1) An implied warranty made to an immediate buyer is extended to a foreseeable remote purchaser under 2-409(a); (2) The warranty is assigned by the immediate buyer to a third person or transferred by operation of law, see 2-409(b)(1); or (3) A court, relying on other state law, extends the warranty to a remote purchaser or user. See 2-409(b)(2). The same analysis applies to the implied warranty of fitness which arises under 2-406.

Under this analysis, it is possible for a manufacturer-seller to make an implied warranty of merchantability to a remote purchaser. Without more, the manufacturer-seller could be liable to a remote purchaser or transferee for consequential damages, including injury to person or property. The likelihood of this is reduced in Exceptions (1) and (2) because the remote purchaser is bound by disclaimers and limitations in the contract between the seller and the immediate buyer. See 2-409(a). There is no such limitation if a court acts under 2-409(b)(2) [Exception #3]. Perhaps the court can be persuaded to apply the limitations in 2-404(e) by analogy.

3. Personal injury.

Without more, a seller who makes and breaches an implied warranty of merchantability can be liable for consequential damages to person or property resulting from the breach, if the conditions of Section 2-806 are satisfied. See 2-806(3), where personal injury damages are excluded from the “disproportion limitation. Except for 2-806(3) and 2-810(c), where an exclusion of liability for consequential injury to person is prima facie unconscionable, revised Article 2 does not distinguish between economic loss and damage to person or property. The special privity rules for personal injury in former 2-318 have been deleted and proposed Section 2-319 in the July, 1996 Draft, which provided special rules for personal injury claims resulting from a breach of warranty, was not approved.

This stance does not resolve the tension between warranty law and tort law where goods caused damage to person or property. The primary source of that tension arises from disagreement over whether the concept of defect in tort and the concept of merchantability in Article 2 are coextensive where personal injuries are involved, i.e., if goods are merchantable under warranty law can they still be defective under tort law and if goods are not defective under tort law can they be unmerchantable under warranty law. The answer to both questions is yes if the contract standard for merchantability, e.g., reasonable expectations, and the tort standard for defect are different. Even though the outcome under different standards will be the same in most cases, i.e., unmerchantable goods are frequently defective and defective goods are frequently unmerchantable, there are a few exceptions, especially where design defects are involved.

The consensus is that the tension should be resolved in a comment to 2-405 rather than in the text of Article 2. There is still disagreement between the Article 2 Drafting Committee and the ALI Council over what that comment should say.

The Drafting Committee supports a comment like this:

“The requirement in subsection (b)(3) that goods, to be merchantable, must at a minimum be “fit for the ordinary purposes for which goods of that description are used” is contract-based. It is derived from the description of goods in a contract for sale. This requirement is not synonymous with the obligation in the law of products liability that the goods not be defective. Conforming goods may be defective if the contract description contemplates goods with those qualities. Goods without defect may fail nevertheless to conform to a particular contract description. In many situations, however, the contract and tort obligations will substantially overlap, particularly where manufacturing defects are involved and personal injuries result. In those situations, determinations whether goods are merchantable should be guided by determinations that goods are or are not defective under product liability law.”

At the December, 1996 meeting of the ALI Council, however, a motion was made and passed (19-0) to the effect that except where breach of an express warranty or an implied warranty of fitness was established, the state should have one standard for defining defect when goods cause personal injuries and that standard should come from applicable tort law. In short, if the goods are both unmerchantable and defective or the goods are not defective but are unmerchantable under the UCC, tort law [preferable the ALI Restatement] determines whether there is liability. One member of the Council suggested the following language for the comment:

“When recovery is sought for injury to person or property the determination as to whether goods are merchantable within subsection (b)(3) is to be determined by applicable state products liability law on the issue of defect.”

At the January, 1997 meeting of the Drafting Committee, the issue was discussed again but no action was taken. One member of the Drafting Committee believes that is no legitimate tension here unless a manufacturer-seller can make an implied warranty of merchantability to a remote purchaser or transferee. He claims that such a warranty is not made under Article 2, especially if liability for consequential damages is excluded in the contract with the immediate buyer.

4. Revised §2-405(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).

SECTION 2-406. IMPLIED WARRANTY OF FITNESS FOR PARTICULAR

PURPOSE. Subject to Section 2-408, 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.

SECTION 2-407. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Language or conduct relevant to the creation of an express warranty and language or conduct tending to disclaim or modify an express warranty must be construed as consistent with each other if this a construction is reasonable. Subject to Section 2-202 with regard to parol or extrinsic evidence, language or conduct disclaiming or modifying an express warranty is ineffective to the extent that this construction is unreasonable.

(b) Subject to subsection (e), an implied warranty is disclaimed or modified by language or an expression that, under the circumstances, makes it clear that the implied warranty has been disclaimed or modified. An implied warranty may also be disclaimed or modified by course of performance, course of dealing, or usage of trade.

(c) Language in a record is sufficient to disclaim or modify an implied warranty if the language is conspicuous and:

(1) in the case of the implied warranty of merchantability, mentions merchantability;

(2) in the case of the implied warranty of fitness, states “There are no warranties which extend beyond the description on the face hereof” or words of similar import;

(3) in the case of used goods, states that the goods are sold “as is” or “with all faults” or words of similar import.

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

(e) In a consumer contract, language is sufficient to disclaim or modify an implied warranty if:

(1) the language complies with applicable disclosure requirements of federal or other state law; or

(2) the consumer expressly agreed to it.

(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.

Notes

1. Subsection (a) preserves the policy that when language creating and language disclaiming or modifying an express warranty are inconsistent, the disclaimer is inoperative, subject to §2-202 (the "parol evidence rule"). Thus if the seller, in contract negotiations, stated that "this car has not been driven more than 25,000 and a subsequent integrated record stated "This car is sold without express warranties, evidence of the oral express warranty should be excluded. In consumer contracts, however, the disclaimer would be excluded from the contract if a reasonable consumer under the circumstances would not expect to find it in the contract. See 2-206(a)

2. Subsection(b)provides the general rule governing the disclaimer 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). The key question is whether under the circumstances, the language, whether or not in a record, "makes it clear that implied warranties have been disclaimer or modified.

The disclaimer or modification of implied warranties by course of performance, course of dealing or usage of trade is now covered in subsection (b).

3. Subsection (c), by stating what language contained in a record is sufficient to disclaim or modify an implied warranty, implements a decision of the Drafting Committee to create a "safeharbor. The Drafting Committee rejected the complex "safeharbor in the January, 1997 Draft and requested a redraft to comply in substance with 2-316(c) of the 1995 Official Text.

Under subsection (c), if language of disclaimer or modification is contained in a record and that language is conspicuous, a valid disclaimer or modification is achieved when the sufficient language for the two implied warranties and for used goods is provided.

Note that a failure to satisfy the "safe harbor" of subsection (c) does not mean that the disclaimer is invalid. Rather, the seller must now meet the more open ended standard in subsection (b).

4. Subsection (d), which states the effect of a pre-contract examination of the goods, applies in both commercial and consumer contracts. As currently drafted, however, the used goods "safe harbor" in subsection (c)(3) applies only in commercial contracts. A seller who attempts to disclaim or modify implied warranties in consumer contract must comply with subsection (e).

5. Subsection (e), which is controversial, stops short of invalidating any disclaimer of the implied warranty of merchantability in a consumer contract. Rather, it states the two conditions that must be met before the disclaimer will be enforced.

The first, compliance with federal or other applicable state disclosure law, was approved at the January, 1997 meeting of the Drafting Committee.

The second, that the consumer “expressly agreed to it, survived a motion to delete at the January, 1997 meeting of the Drafting Committee and remains in the Draft even though the 1995 Annual Meeting of NCCUSL voted to delete a provision in the July, 1995 Draft made language of disclaimer inoperative unless the seller proved by “clear and affirmative evidence that the buyer expressly agreed to it. Nevertheless, the “expressly agreed language was retained in the July, 1996 Draft and survived the 1996 NCCUSL Annual Meeting.

When does a consumer “expressly agree to a disclaimer? The answer is when the consumer was aware of the term (if not its implications) in the record and separately signed or initialed the term. Express awareness followed by a signature on the record arguably is not enough. Although the burden is on the seller to establish that the consumer did expressly agree at the time of contracting, when that burden is satisfied the consumer can no longer claim that the term was not reasonably expected under 2-206(a).

A possible distinction between disclaimers in direct relationships and disclaimers in “packaged clauses delivered through intermediaries was recognized by the Drafting Committee but was not implemented in the statute.

SECTION 2-408. 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 or model prevails over inconsistent general language of description.
- (3) Except in a consumer contract, an express warranty prevails over an inconsistent implied warranty other than an implied warranty of fitness for a particular purpose.

SOURCE: Sales, Section 2-317.

Notes

1. One change was made in §2-409. An implied warranty of merchantability in a consumer contract that is inconsistent with an express warranty is not displaced under §2-409(3). Rather, the requirements of §2-406(b) must be satisfied.

SECTION 2-409. EXTENSION OF EXPRESS OR IMPLIED WARRANTY.

(a) A seller's express or implied warranty made to an immediate buyer extends to any remote buyer or transferee that may reasonably be expected to use or be affected by the goods and that is damaged by a breach of warranty. The rights of the remote buyer or transferee and its

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. However, the seller is not liable for consequential lost profits for breach of warranty under this section.

(b) This Section and 2-404 do not displace:

(1) the rights and remedies of a third party beneficiary or assignee under the law of contracts or of persons to which goods are transferred by operation of law;

(2) principles of law and equity that extend an express or implied warranty to or for the benefit of a remote buyer, transferee, or other person.

(c) The operation of this section may not be excluded, modified, or limited unless the seller has a substantial interest in having a warranty extend only to the immediate buyer.

SOURCE: Sales, Section 2-318.

Notes

1. Overview. Section 2-409, which is based on 2-318(c) in the 1995 Official Text, deals with warranty claims by a remote purchaser or transferee against "the seller" with whom there is no privity of contract. It is in addition to the express warranty obligations created under 2-404 but is subject to the definitions in 2-401. The section operates as follows:

Subsection (a). Under subsection (a), the seller's warranty made to an immediate buyer is extended to a foreseeable purchaser or transferee (i.e., a person who obtains title to or an insurable interest in the goods) who is damaged by the breach. The warranty under this draft, however, is not extended to other persons who might be expected to use or be affected by the goods. Thus, the warranty extension is vertical, not horizontal.

At the ALI Council meeting in December, 1996, the Council supported a motion that foreseeable users or persons affected who suffer economic loss from breach of an express warranty should be restored to subsection (a). At the January, 1997 meeting, however, the Drafting Committee narrowly rejected a motion to extend the warranty to a "natural person who is in the family or household of the purchaser or transferee and has suffered economic loss but not loss of profits."

The protected remote person's rights against the seller are defined and 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. Express warranties under 2-404, however, are not so limited. They create direct obligations to the remote purchaser. Thus, limitations in the contract between the seller and the immediate buyer would not bind the remote purchaser.

Moreover, where there is no exclusion in the contract with the immediate buyer the seller

is still not liable to a remote purchaser or transferee for “consequential lost profits. See 2-806. Thus, a remote and otherwise protected purchaser could not recover lost profits resulting from the breach but could recover other consequential damages, including injury to person or property.

Although protected persons may be called beneficiaries, the warranty extension is based more upon policy than intention of the parties. The seller should be responsible to foreseeable buyers and transferees for the quality of the goods warranted to the immediate buyer. But since the warranty is derivative, the protected purchaser or user 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. **A motion to restore the “three alternatives” approach of former 2-318 was defeated at the November, 1996 meeting.**

Subsection (b).

Subsection (b) states two things that are not displaced by 2-409.

Subsection (b)(1) clarifies that Section 2-409 supplements rights and remedies of third party beneficiaries and assignees under contract law and transferees by operation of law. For example, 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 §2-503. 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 §2-503 rather than §2-410(a). A leading case is *Collins Co. v. Carbonline Co.*, 864 F.2d 560 (7th Cir. 1989).

Subsection (b)(2), taken from 2A-316, states that neither 2-404 nor 2-409 displace “principles of law and equity that a court might use to extend a warranty beyond the immediate buyer. 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). Since 2-409 does not state the remote purchaser's rights and remedies, they would be those under Article 2, as modified to fit the particular case. See 2-404(3), which might be applied by analogy.

2. Subsection (c) states that the “operation of this section cannot be varied by agreement, unless the seller has a “substantial interest in making the warranty only to the immediate buyer. See 2-503(b). This change was approved at the January, 1997 meeting of the Drafting Committee. Subsection (c), however, does not limit the power of the seller and immediate buyer to shape the terms of the contract. Rather, it applies after the warranty and remedy terms have been agreed.

3. The definition of “the seller” in §2-401 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 §§2-404 and 2-409. Complex federal preemption issues aside, a foreign seller is not insulated from warranty extensions to remote non-CISG buyers under the UCC. See Richard E. Speidel, The Revision of

UCC Article 2, Sales in Light of the United Nations Convention on Contracts for the International Sale of Goods, 16 Nw. U. J. of Int'l Law & Bus. 165, 178-188 (1995).

4. Section 2-410(b) in the November, 1996 draft has been deleted. See 2-404(e).

5. Section 2-411 in the November, 1996 Draft, dealing with “Injury to Person or Property Resulting from Breach of Warranty, has been deleted.

PART 5

TRANSFERS, IDENTIFICATION, CREDITORS, AND GOOD-FAITH PURCHASERS

SECTION 2-501. PASSING OF TITLE; RESERVATION FOR SECURITY.

(a) Except as otherwise expressly provided in this article, this article applies whether or not the seller, the buyer, or a third party has title to or possession of the goods and despite 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 to goods 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) Subject to Section 2-104(a)(1), 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:

(A) if the contract requires or authorizes the seller to send goods to the

buyer but does not require the seller to deliver them at a particular destination, title passes to the buyer at the time and place of shipment; and

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

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

(d) If delivery is to be made without moving goods and the goods are already identified at the time of contracting and no document of title is to be delivered, title to the goods 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; Licenses, Section 2B-501.

Notes

1. No changes of substance have been made in §2-401 of the 1990 Official Text.
2. Although a sale occurs when title passes from seller to buyer for a price, §2-102(a)(), the location of title is largely irrelevant under Article 2. The same is true under CISG. See Art. 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 2-501 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 §2-501 are applicable to them.
3. Except for the rights of buyers in ordinary course of business out of inventory, passage of title to goods covered by a certificate of title is governed by the applicable Certificate of Title Act. See 2-104(a)(1). The CTA, however, may or may not preempt 2-401. See, e.g., Aetna Casualty & Surety Co. V. A.L.J.A., Inc., 905 F. Supp. 36 (D. Mass. 1995)(Massachusetts CTA does not abrogate 2-401, it simply adds further requirements). But see Ladd v. Ford Consumer Finance Co., Inc., 550 N.W.2d 826 (Mich. App. 1996)(Michigan Mobil Home Commission Act supersedes 2-401).

SECTION 2-502. 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 expressly agreed to by the parties. In the absence of express 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 breach of contract 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.

Notes

1. Subsection (a) is revised for a clearer focus on how and when goods are identified to the contract. See §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 §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 §2-502(c). No change is made. In light of §2-502(d), the insurable interest of both seller and buyer complements or is in addition to insurable interests recognized by other sources of law. See 2A-218 on "insurance and proceeds.

4. Advantages of Identification. The advantages to the buyer of identification and obtaining a "special property interest" are not stated in §2-502. These advantages include: (1) The acquisition of "goods oriented" remedies against the seller under §§2-824 and 2-807; (2) Protection against the seller's creditors under §2-505; (3) Earlier status, in some states, as a buyer in ordinary course of business under §1-201(9); (4) A right to inspect the goods under §2-611(a); and (5) Standing to sue third parties who cause injury to identified goods, §2-813.

Similarly, the advantages to the seller of identification are not stated in §2-502. These advantages include: (1) Shipment under reservation, §2-608(a); (2) Resale under §2-819(a); (3) Possible excuse where goods identified at the time of contracting are damaged or destroyed, §2-715; (4) Possible action for the price upon breach by the buyer, even though the goods have not been accepted, §2-822(a)(2); and (6) Standing to sue third parties who cause injury to identified goods, §2-813. In addition, the seller, upon breach, may make a commercially reasonable decision to identify goods to the contract and pursue appropriate remedies. See §2-817.

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 Art. 32(1), dealing with notice requirements when goods shipped by the seller are not "clearly identified to the contract."

SECTION 2-503. ASSIGNMENT OF RIGHTS; DELEGATION OF DUTIES.

(a) All rights of a seller or buyer, including 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 unless the assignment would materially change the duty of the other party, increase the burden or risk imposed on that party by the contract, or impair that party's likelihood of obtaining return performance.

(b) A party may delegate to another person 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. A delegation of performance does not relieve the delegating party of any duty to perform or liability for breach.

(c) 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 assurance of due performance from the assignee.

(d) 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 indicate the contrary, as in an assignment for security, the assignment or transfer is a delegation of performance of the duties of the assignor.

(e) If a contractual term prohibits the assignment of rights otherwise assignable under subsection (a), the assignment is effective. However, whether or not the contract so provides, the assignment is a breach of contract for which damages under this article are available.

(f) A contractual term prohibiting the delegation of duties otherwise delegable under subsection (c) is enforceable, and an attempted delegation is not effective. 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.

SOURCE: Sales, Section 2-210; Leases, Section 2A-303; Licenses, Sections 2B-502, 2B-507.

Notes

1. This section reintegrates 2-211 (July, 1996) with 2-403 (July, 1996) and revises the integration to deal more specifically with terms that prohibit assignments and delegations that are otherwise enforceable. See 2A-303.

2. Subsection (a) states the default rule on an assignment of rights. They are enforceable unless.... (see the "unless" clause). Rights are broadly defined ("all"). See also, subsection (d)(rules of interpretation). Subsection (e), however, provides that a term prohibiting an otherwise permissible assignment of rights is not enforceable, i.e., the assignment is effective. The prohibited assignment is a breach of contract for which damages can be recovered under the general principles of 2-804. See 9-318(4).

3. Subsection (b) states the default rule for a delegation of duties: They are enforceable "unless" (first sentence). The second sentence of subsection (b) states the effect of a delegation of duties on the duty of the delegator to a non-consenting party and subsection (c) states the effect of the delegatee's acceptance of the duties delegated. There are no changes from Section 2-210 of the 1990 Official Text. Subsection (f) makes clear that, unlike a prohibition of assignment of rights, a term prohibiting the delegation of duties is effective and provides some rules of interpretation.

4. Because of differences in the underlying transaction, 2-503 is less complex than 2A-

303. For example, there is no need for a special treatment of “residual interests in goods, 2A-303(2), and a provision on terms which prohibit the creation and perfection of security interests, 2A-303(3), appears to be unnecessary. Moreover, Section 2-503 is consistent with the basic principles of assignment and delegation law (although not an exhaustive statement) and has survived an occasional testing in the courts. See *Baxter Healthcare Corp. v. O.R. Concepts, Inc.*, 69 F.3d 785 (7th Cir. 1995); *Sally Beauty Co. v. Nexxus Products Co.*, 801 F.2d 1001 (7th Cir. 1986).

5. 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 §2-409(b)(1).

SECTION 2-504. 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 purchase from a seller that has relinquished possession or control has power to transfer good title to a good-faith purchaser for value until the seller regains possession or control.

(c) For purposes of this section, a 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.

(d) The entrusting of possession of goods to a merchant that deals in goods of that kind gives the merchant and a buyer from that merchant power to transfer all rights and title of the entruster and to transfer the goods free of any security interest perfected by the entruster under Article 9 to a buyer in the ordinary course of business.

(e) 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.

Notes

1. Section 2-504, formerly §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 2-504(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 2-504(b) states the good faith purchaser exception to the nemo dat principle. The BFP's seller must obtain voidable rights or title in a 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. See *Inmi-Etti v. Aluisi*, 492 A.2d 917 (Ct. App. Md. 1985) (“voidable title cannot be obtained unless there is a voluntary transfer of the goods”).

The power to pass good title includes but is not limited to the four situations stated. Remaining questions about the scope of “purchase”, when title or rights are voidable, and who is a good faith purchaser for value are left to the courts. See *Johnson & Johnson Prod. v. Dal Intern. Trading Co.*, 798 F.2d 100 (3d Cir. 1986)(good faith purchaser of voidable title protected).

2. Section 2-504(d) protects a BIOCB from a merchant to whom goods have been entrusted, see 2-504(e): The BIOCB takes free of “all rights and title” of the entruster. See *Prenger v. Baker*, 542 N.W.2d 805 (Iowa 1995).

Normally, a BIOCB will take free of a security interest “created by his seller” under 9-307(1), even though the secured was not an entruster under 2-504(e). See *Key Bank v. Maine v. Estes*, 669 A.2d 162 (Maine 1995)(consumer debtor purchases boat and, without secured party’s consent, purchases a business, consigns boat to himself, and sells to BIOCB). Occasionally, a secured party will gain control of goods in which it has a security interest and entrust them to a merchant who did not create the security interest, see §9-307(1). Under revised 2-504(d), the entrusting secured party will lose the security interest to a buyer in the ordinary course of business. See *Sears Consumer Fin. Corp. v. Thunderbird Prods.*, 802 P.2d 1032 (Ariz. 1990).

3. The “shelter” principle operates, see subsection (d). Thus, if goods are entrusted to a merchant for repair and the merchant sells them to a non-merchant, the non-merchant purchaser from the merchant also has power to transfer good title to a BIOCB.

4. This section is subject to applicable certificate of title legislation. Section 2-104(a)(1). If that legislation clearly states that title passes to covered goods only upon the delivery of a proper certificate of title, Section 2-503 does not apply. Otherwise, the certificate may be presumptive evidence of title but the ultimate question of “good title” is determined under Section 2-503.

SECTION 2-505. RIGHTS OF SELLER'S CREDITORS AGAINST GOODS

SOLD.

(a) Except as otherwise provided in subsections (b) and (c), the 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 rights under Sections 2-807, 2-822, and 2-824(b) if the buyer's rights vest before a creditor's claim in rem attaches to the goods.

(b) A creditor of a seller which has retained 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 in current course of trade.

(c) Except as otherwise provided in subsection (a) or Section 2-504(d), this article does not impair rights of a creditor of the seller under Article 9 or in a case in which an identification to the contract or delivery is made other than 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 the transaction would constitute a fraudulent transfer or voidable preference under any statute or rule of law other than this article.

SOURCE: Sales, Section 2-402.

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 §§2-824 (formerly §2-502), 2-807 (formerly Section §2-716) and 2-822(b) (formerly 2-709(2)). 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 over those creditors in the goods or the proceeds. The language in subsection (a) (proposed by the ABA Task Force) states the priority rule: The buyer's rights must vest before the creditor's in rem claim attaches.

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 §§2-824 and 2-807 or §2-504(c) is involved. Revised subsection (a), however, provides a priority rule if the buyer's right vests before the security interest attaches. If the security interest attaches first, the buyer's right to possession from the seller is preserved subject to the security interest unless the buyer is in the ordinary course of business.

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 §§2-824 or 2-807.

#1. C becomes an unsecured creditor of S either before or after the contract for sale. C loses to B unless in every case unless S's retention is fraudulent under §2-505(b) or subsection (c)(2) applies.

#2. LC obtains a judicial lien on the goods either before or after S retained possession. After the sale, B obtains a special property interest by virtue of identification, 2-502, and a right to possession of the goods under 2-824 (i.e., B's right vests). If LC's lien attaches before B's rights vest, B takes subject to the judicial lien. If LC's lien attaches after B's rights vest, B takes free of the lien under subsection (a).

#3. SP creates a security interest in the goods which attaches either before or after the buyer's rights vest. If before, a buyer in the ordinary course of business may take free of that security interest under §9-307(1) or §2-504(c). B's status as a BIOCB should arise upon identification of the goods not when possession is transferred. If after, SP may take subject to buyer's rights in the collateral, even though the buyer has not perfected a security interest.

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. Moreover, the problem sparked interest at the 1996 Annual Meeting and discussion continued at the September, 1996 meeting of the Drafting Committee (where a motion to give the buyer a "super" priority under Article 2 was narrowly defeated). Although a general consensus has emerged on some issues, others remain for decision. More specifically, when does the buyer protected under Article 2 become a BIOCB? The right to possession (which protects the buyer's need for the goods) is undercut unless the BIOCB status arises when the buyer has a right to possession against the seller, not when possession is actually taken. In effect, this right arises when the buyer has a special property interest in the goods and the right to possession arises under 2-824 or 2-807.

SECTION 2-506. 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 an acceptance, but a failure seasonably to notify the seller of election to return the goods is an acceptance, and acceptance of any part of conforming goods is an acceptance of the whole; and

(3) after reasonable notification of election to return, the return is at the seller's risk and expense, but a merchant buyer shall 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 a contract within the provisions of this article on parol or extrinsic evidence.

(e) 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 [if delivered to a merchant buyer and are in that] buyer's possession.

SOURCE: Sales, Sections 2-326, 2-327.

Notes

1. Section 2-506 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 §2-327 has been rolled into §2-506 and the material on consignments and creditor's rights, previously in §2-326, was contained in a new §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 §2-407 to Article 9. Thus, except for 2-504(c) on entrusting, Article 2 has nothing to say about either a bailment or a consignment transaction, whether or not creditor's rights are involved. Is this wise?**

2. New §2-506(e) preserves the traditional creditor's rights distinction between "approval" and "return." With the deletion of 2-407 in an earlier draft,[see below], Article 2 says nothing about what those creditor rights are and what the seller can do trump them. A possible solution, included in revised subsection (e), makes creditor's rights (whatever they are) depend upon whether the seller in a sale or return delivered them to a merchant buyer. **It has been suggested, however, limiting protection to cases where the buyer is a merchant is unsound. Do you agree? See the underlined language in subsection (e).**

To illustrate, suppose a brewery sells beer to a retailer to be "returned" if the beer is not sold before the "freshness" expiration date. In this "sale or return" 2-506 deals with the rights between the parties and states that the beer, while in the buyer's possession, is subject to the rights of the buyer's creditors. Which creditors, what rights and what precautions the seller can take are not stated. If, instead, the beer is "consigned" to the retailer, Article 2 says nothing about anything. Where secured creditors are involved, Article 9 will have something to say, but exactly what is still not clear.

3. Former Section 2-326 (1990 Official Text), renumbered 2-407 in the July, 1995 Draft, was deleted by the Drafting Committee at the March, 1996 Meeting. The UCC will treat the consignment problem in 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.

4. Assuming that revised Article 9 will ultimately cover most aspects of a consignment for security, there are no code provisions covering a "pure consignment, i.e., a bailment with the bailee acting as an agent with power to find a buyer for the consigned goods and to transfer good title by a contract for sale to that buyer. Moreover, there may be a gap in coverage for consignments for security between the enactment of Article 2 and Article 9.

One observer has suggested that the essence of old 2-326(3) be retained a subsection (f) until the Article 9 project is completed. Do you agree?

PART 6

PERFORMANCE

SECTION 2-601. GENERAL OBLIGATIONS. Parties to a transaction subject to this article are obligated to perform in accordance with the contract ~~and this article~~.

SOURCE: Sales, Section 2-301.

Notes

1. Section 2-601 is taken from §2-301 of the December, 1994 Draft. See CISG Art. 30 & 53. This phrasing of the parties' obligations is broader than that stated in former §2-301. The broader phrasing is intended to encompass all of the obligations of the parties' contract, not merely those related to delivery and payment for the goods. The words "substantial impairment in the caption are deleted to reflect the change made from the July 1996 draft described below. The phrase "and this article" is deleted as unnecessary. The definition of contract in §1-201(11) means the total legal obligation of the parties from their agreement, the U.C.C. and any other applicable rule of law. Thus the requirements of Article 2 are already part of the parties' contract.

2. Subsections (b) and (c) in the July, 1996 Draft of 2-601 have been deleted: They simply restated general principles of contract law. Subsection (b) stated that subject to this Article (and unless otherwise agreed) one party's duty to perform was 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 effect of a non-material breach, which followed general contract law, was stated in subsection (c).

3. Service agreements. Section 2-602 in the July, 1996 Draft, dealing with service agreements relating to good sold, was deleted at the November, 1996 meeting of the Drafting Committee. There was, however, some sentiment to deal with service obligations when

provided in lieu of the other remedies under Article 2. For example, a seller may promise to repair as the exclusive agreed remedy. The issues represented by that promise are (i) what is the level of performance of that repair obligation, (ii) what are the remedies of the buyer if the repair remedy is not provided (failure of essential purpose). Those two issues are addressed in draft § 2-810. The remainder of the sections in part 6 have been renumbered to reflect the deletion of this section.

4. Section 2-603 in the July, 1996 Draft, dealing with waiver of objection, has been moved to part 7. All waiver of breach concepts are now contained in Section 2-702.

SECTION 2-602. MANNER OF SELLER'S TENDER OF DELIVERY.

(a) To tender delivery, a seller shall put and hold conforming goods at the buyer's disposal 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 agreement does not require delivery at a particular destination, tender requires that the seller deliver conforming goods to the carrier and comply with Section 2-603.

(c) If the agreement requires the seller to deliver at a particular destination, tender requires compliance with subsection (a) and, in an appropriate case, the tender of documents pursuant to 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 of a seller are in the possession of a bailee and are to be delivered to a buyer 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 voids 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 an agreement requires a 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.

Notes

1. Three minor changes were made in former §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 §2-602 requires conforming goods.

2. With the repeal of the delivery terms in former §§2-319 through 2-323 in favor of a flexible interpretation standard, see §2-309, §2-602 becomes an important interpretive source for determining disputes over risk of loss under §2-612.

3. The seller's tender of delivery has ~~two~~ three important consequences:

First, it satisfies a condition to the buyer's duty to accept and to pay for the goods. See §2-606(a). Unless otherwise agreed, the buyer is not in breach until there is a tender of delivery. Compare §2-607, dealing with the buyer's tender of payment.

Second, it is an essential ingredient in the passage of risk of loss under §2-612 (alternative 2), in that tender either passes the risk or is an essential first step to transfer of possession of the goods. Tender of delivery in §2-602 is stated in terms of conforming goods. To the extent passage of risk of loss is not dependent upon tender of conforming goods (§2-612 (alternate 1)), tender will not necessarily have anything to do with risk of loss.

Third, tender of delivery is usually the time for testing whether goods conform to the contract for purpose of determining the buyer's right to reject as well as breach of contract. Section 2-403 contemplates using the time when risk of loss would pass to determine conformity. That would represent a significant change from current law and would necessitate changes to other code sections such as the rejection section §2-703 and statute of limitations §2-714 both of which are now keyed to tender of delivery. In addition, it would be odd to test conformity for

purpose of an express warranty at a point that is different than the time for testing for conformity to an implied warranty. Thus, the committee needs to decide whether the time for testing conformity should be at tender of delivery or at the time the risk of loss passes. If the committee decides that the time for determining conformity should be when the risk of loss passes to the buyer, then corresponding changes would have to be made throughout the draft.

The Reporters recommend that the tender of delivery test be retained.

In any 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 §§2-319 through 2-324 have been deleted.

4. Definition of bailee. Article 2 uses the word "bailee" in four sections, §§2-602(d), 2-612(c), 2-816(a) and 2-818(c), but does not define it. Neither does Article 2A. Article 1 uses the word in a broader definition of document of title. §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 because 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, §2-305(b), [CISG Art. 31(b) is in accord] and the adequacy of the tender of delivery is governed by §2-602(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 §2-602(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 §2-602 and Article 32 the counterpart of §2-603.

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 §§2-305(a) and 2-602(a).

7. It should be noted that draft §9-311(c) proposes a change from current §9-304 and §9-305 which provide that a secured party may perfect its security interest in the goods in the hands of a bailee who has not issued a negotiable document of title for the goods by mere notification

to the bailee. Draft §9-311(c) provides that the secured party does not perfect its security interest in goods in the hands of the bailee who has not issued a negotiable document for those goods until the bailee acknowledges that it holds the goods for the secured party. Are the policy issues different in this context that mere notification should fix rights as against third parties under §2-602(d)(2)?

SECTION 2-603. 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 following rules apply:

(1) The seller shall put the goods in the possession of a carrier. However, unless requested by the buyer or required by usage of trade, the seller need not make a contract for their transportation or obtain and deliver any documents necessary to enable the buyer to obtain possession of the goods.

(2) The seller shall promptly notify the buyer of the shipment if the goods are not clearly identified to the contract by markings on the goods, shipping documents, or otherwise.

(b) A seller's failure to notify the buyer of the shipment or to make a proper contract for transportation, if so required by subsection (a), is a ground for rejection only if material delay or loss results.

SOURCE: Sales, Section 2-504.

Notes

1. At the January, 1994 meeting of the Drafting Committee, former §2-504 was criticized as being out of step with commercial practice. Normally, the seller is not expected to make arrangements for shipment unless required by the contract or commercial usage and practice. It was suggested that CISG Art. 31(a) and 32 were more consistent with current practice. In response to further discussion at the September, 1996 meeting of the Drafting Committee, 2-603 was revised to follow CISG, described below.

Note that 2-603 states the rules of tender when the seller is not obligated to deliver at a particular destination. The rules for tender in destination contracts are stated in §2-602(c) and assume that the seller bears the cost and risk of making an appropriate contract for shipment with the carrier. **Review 2-309 and the Notes.**

2. CISGA. Many international contracts for sale involve "carriage of the goods." In the absence of agreed delivery terms, such as the Incoterms 1990 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." Art. 31(a). If the goods are "clearly

identified to the contract" the seller need not notify the buyer of the "consignment." Art. 32(1). More to the point, unless the seller is "bound to arrange for carriage of the goods" it need not make any contracts for carriage. Art. 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." Art. 32(3).

SECTION 2-604. 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 which 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 2-603. 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.

Notes

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

2. **CISGA.** There is no comparable provision in CISGA. Article 58(1) & (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. Art. 58(3).

SECTION 2-605. RIGHTS OF FINANCING AGENCY.

(a) A financing agency, by paying or purchasing for value a draft or honoring a presentation under a letter of credit that relates to a shipment of goods, acquires, to the extent of the payment or purchase or honor 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 in good faith has honored or purchased the draft or honored a presentation under a letter of credit under commitment to or authority from a 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.

Notes

There is one change in former §2-506. Because a presentation under a letter of credit need not be accompanied by a draft as defined in Article 3, §5-102 Comment 11, but the rights obtained by an honor of a presentation under a letter of credit should be comparable, the phrasing of this section has been broadened to include presentations under a letter of credit.

SECTION 2-606. EFFECT OF SELLER'S TENDER; DELIVERY ON CONDITION.

(a) Tender of delivery is a condition to a buyer's duty to accept and pay for the goods. Tender entitles the seller to acceptance of the goods and payment according to the agreement. The seller shall tender first but does not have a duty to complete delivery until the buyer has tendered payment.

(b) Subject to Section 2-816, 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.

Notes

1. There are two substantive changes in revised §2-606.

First, the second sentence in §2-606(a) provides that the seller rather than the buyer shall

tender first, unless otherwise agreed. See §2-607. 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 §2-816 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 2-607. TENDER OF PAYMENT BY BUYER; PAYMENT BY CHECK.

(a) Subject to Section 2-606(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 voided as between the parties by dishonor of the check on due presentment.

SOURCE: Sales, Section 2-511.

Notes

1. There are no revisions of substance in §2-607. Under revised §2-606(a), however, unless otherwise agreed the seller must tender delivery before the buyer has a duty to tender payment and under §2-609(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. Art. 58(1) & (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 2-608. 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 Article 5.

(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.

Notes

1. There are no changes of substance in former §2-512. See 5-109(b)(injunction against honor).

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 §2-608.

SECTION 2-609. BUYER'S RIGHT TO INSPECT GOODS.

(a) If goods are tendered or delivered or identified to a contract for sale, the 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 2-608(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.", "C.I.F.", or "C. & F." or on similar terms; or

(2) payment upon tender of required 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.

Notes

1. There are no changes of substance in former Section 2-513. The meaning of the phrase payment "against documents of title" in former 2-513(3), however, is now less certain because the phrase has been removed from the Incoterms of the International Chamber of Commerce and the delivery terms, "C.I.F. and C. & F. terms, both of which seemed to define the phrase, have been deleted from revised Article 2. See former 2-320(4) and 2-321(1). To emphasize that the phrase depends upon what the contract requires (it could a delivery term of not) rather than a customary meaning, the phrase upon "tender of documents" has been substituted for "payment against documents."

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

The buyer must act fast to examine the goods, Art. 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, Art. 40, and is entitled to damages if "he has a reasonable excuse for his failure to give the required notice."

SECTION 2-610. WHEN DOCUMENTS DELIVERABLE ON ACCEPTANCE OR PAYMENT. Documents against which a draft is drawn must be delivered to the drawee or to the issuer of a letter of credit that honors the draft on acceptance of the draft if the draft is payable more than [a reasonable time] [three days] after presentment. Otherwise, delivery is required only on payment.

SOURCE: Sales, Section 2-514.

Notes

1. There are no revisions of substance in former §2-514. "Acceptance" in the text of § 2-

610 means "acceptance" as defined in §3-409(a)--a "signed agreement to pay a draft as presented"--rather than "acceptance" as defined in §2-706. See §4-503(1), dealing with documentary drafts presented by a bank.

This section is a default rule for when the person presenting the draft to the buyer (drawee) may surrender the documents to the buyer. The two possibilities are when the draft is accepted by the buyer under §3-409 or when the draft is paid by the buyer. Under §4-503, when the presenter is a bank, the presumption is that if the draft is payable more than 3 days after presentment, then the buyer's acceptance is sufficient for the presenting bank to surrender the documents to the buyer. The following issues should be resolved:

First is there a need to allow more flexibility in the default rule as to whether an acceptance is all that is required to surrender the documents in a case not covered by §4-503?

Second, if more flexibility is needed here, then why is the rule 3 days when the presenter is a bank under §4-503? This is not a rule that determines how long the drawee has to honor the presentation but rather what presumption to apply as to when documents must be delivered. The key language is taken from 5-108(b). The "seventh business day" outer limit, however, was not added. This is more flexible than three days (the former time) but may still not be instructive enough. Suggestions? The added language regarding honor of a letter of credit is provided to better coordinate with the issuer's rights under §5-108.

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

**SECTION 2-611. OPEN TIME FOR PAYMENT OR RUNNING OF CREDIT;
AUTHORITY TO SHIP UNDER RESERVATION.**

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

(b) If a 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 agreement.

(c) If tender of delivery is agreed to be made by way of documents of title, payment is due at the time when 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.

Notes

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

SECTION 2-612. RISK OF LOSS.

Alternative A.

(a) As used in this section, “goods mean both conforming and nonconforming goods.

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

(c) If a contract requires or authorizes the 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 2-602 and 2-603, 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 goods are tendered as required by Section 2-602.

(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 with any required indorsement;

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

(3) after the buyer's receipt of a nonnegotiable document of title or record directing delivery, as provided in Section 2-602(d)(2).

(d) A breach of contract by either party affects risk of loss only in the following cases:

(1) If the buyer rightfully and effectively rejects the goods or revokes acceptance

of the goods, the seller has the risk of loss from the time when the rejection or revocation is effective.

(2) If the seller has tendered nonconforming goods, the risk of loss has passed to the buyer, and the goods are damaged or lost before the buyer effectively rejects or revokes acceptance, the seller has the risk of loss to the extent the nonconformity of the goods caused the damage or loss.

(3) If conforming goods are identified to the contract when the buyer repudiates or is otherwise in breach and the risk of loss has not otherwise passed to the buyer, the buyer has the risk of loss for those goods for a commercially reasonable time after the breach or repudiation.

(e) This section is subject to Section 2-506(b) and (c).

Notes

1. This section adopts the perspective that opportunity to control the goods and prevent the loss is the only thing that matters to passage of the risk of loss as a default rule (in the absence of parties' contrary agreement). Thus passage of the risk to the buyer is not dependant upon the conformity of the goods to the contract. See subsection (a). This presents a significant change from current law. Under former §§2-509 and 2-510(1) tender of conforming goods was a prerequisite to the passage of the risk of loss as an initial matter. The basic principle, now stated in subsection (b), 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 §2-509(3) drew an unpersuasive distinction between the merchant and non-merchant seller. Under revised subsection (b), risk remains on the seller, who is in the best position either to 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 §2-602(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. Also the fact that S's tender may have been non-conforming is irrelevant.

2. Except as stated in subsection (e), risk of loss principles do not affect the parties' obligations under the contract. The seller must tender and the buyer must pay as agreed. Thus, a buyer with the risk who fails to pay as agreed may be liable for the price. Similarly, a seller with the risk is still obligated to deliver the goods as agreed.

3. For risk of loss purposes, the term "carrier" in §2-612(c) 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, including private express mail, United Postal Service and 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.

4. 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 §2-509(3). A similar requirement appears in §2-602(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 who has issued a document of title, see §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 §2-612(d). Instead, the question is whether B has the risk of loss under either §2-612(b) or §2-612(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.

5. Even though the risk might pass to the buyer initially upon the events happening in subsections (a) through (d), subsection (e) recognizes that there may appropriate exception to that rule. The exception of subsection (e)(1) is designed to bring the risk of loss rules into conformity with the rules regarding remedies for breach of contract provided in the rest of the Article.

To illustrate.....(assume nonconforming goods)

(a) S tenders goods. RL on S until B receives or takes control. B has no price liability. [current law]

(b) B receives goods but does not accept. In this interval between receipt and possible rejection, RL on B. [Not current law. See 2-510(1)] If loss before rejection, B does not owe price but S bears economic loss to extent nonconformity causes the loss. If loss after rightful rejection, full risk on S. B is a bailee and must exercise ordinary care. S may be entitled to proceeds of B's insurance, if any.

(c) If B accepts and does not rightfully revoke, RL on B and B owes price, subject to deduction. [Current law.] If B rightfully revokes, risk back on S from time of revocation regardless of who has adequate insurance [Not current law. 2-510].

6. Assume the risk of loss has passed to the buyer under subsections (a) through (c) above. The buyer wrongfully but effectively rejects the goods. In that situation, the risk of loss in effect passes back to the seller only if the seller had retained or regained possession of the goods and the goods are lost or destroyed after a reasonable time after the risk had passed to the buyer. §2-822. If the goods are destroyed within that reasonable time after the risk of loss passed, and the goods are conforming (making the rejection wrongful), the buyer in effect has the risk of loss because the seller is able to get the price. §2-822. Assume the risk of loss passes to the buyer under subsections (a) through (d) above. The buyer attempts a wrongful revocation. The goods are then destroyed. That revocation does not undo the buyer's acceptance of the goods and the seller is still able to get the price for the goods. §2-822. In effect, the buyer retains the risk of loss.

7. Subsection (e)(2) recognizes one instance of where the risk of loss resting on the buyer prior to rejection or revocation might be unfair to the buyer even when the buyer has not rejected or revoked, that is where the nonconformity of the goods causes the loss or damage to the goods

prior to a rejection or revocation. Assume the goods are improperly packaged and the risk passed to the buyer under subsection (d) when the buyer gets an indorsed negotiable document covering the goods. The improper packaging makes the goods non-conforming. Before buyer can inspect the goods, because of the improper packaging, the goods get wet and are damaged. Seller would bear the risk of loss in that situation as to the damaged goods. Otherwise, before rejection or revocation being effective, buyer bears the risk of loss if one of the times noted in subsections (a) through (d) have come to pass.

8. A rationale for former §2-510(3) was that a buyer who repudiated or breached by failing to take delivery unfairly surprising the seller, should have the risk of loss for the time necessary for the seller to do something with the goods. Subsection (e)(3) is advanced for discussion as to that principle. The effect of putting the risk of loss on the buyer in the situation in subsection (3) is to give the seller the ability to get the price under §2-822. If buyer does not have the risk of loss in the circumstances contemplated in subsection (3), seller still has all other available remedies for breach because of the repudiation or failure to take delivery of conforming goods.

9. Former §2-510, dealing with the effect of breach on risk of loss, has been repealed. 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 §2-612 is dubious, especially where there is no causal connection between the breach and the loss itself. Absent a causal connection, the party to whom the risk has passed at the times stated in subsections (a) through (d) is still in the best position, cost considered, to avoid or insure against the loss.

Moreover, application of the "breach" standard in old §2-510 produced unexpected difficulties. For example, under §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 §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 §2-510(2) that dictated this result.

Similarly, under §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 §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, §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 little evidence that insurance companies were aware of §2-510, much less that they calculated premiums with the availability of subrogation in mind.

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

Art. 67(1), dealing with "carriage of the goods," is comparable to §2-612(c). 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.

Art. 68, dealing with goods sold in transit, has no exact counterpart in §2-612, the closest provision being §2-612(c). Furthermore, there is no provision like §2-612(d), which treats goods in the possession of a bailee.

Cases not otherwise covered are picked up in Art. 69, which is CISG's equivalent to old §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 Art. 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." Art. 66. Also, under Art. 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. Art. 70.

Alternative B

(a) Except as otherwise provided in this section, the risk of loss passes to a buyer upon receipt of conforming goods. If the buyer does not intend to take possession, risk of loss passes when the buyer receives control of the conforming goods.

(b) If a contract requires or authorizes the 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 conforming goods are tendered and delivered to the carrier as required by Sections 2-602 and 2-603 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 conforming goods are tendered as required by Section 2-602.

(c) If conforming 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 with

any required indorsement;

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

(3) after the buyer's receipt of a nonnegotiable document of title or record directing delivery as provided in Section 2-602(d)(2).

(d) A breach of contract by either party affects risk of loss only in the following cases:

(1) If a buyer accepts nonconforming goods under Section 2-706, the risk of loss passes to the buyer upon acceptance.

(2) If a buyer effectively and justifiably revokes acceptance, the seller has the risk of loss from the time the revocation is effective.

(3) If the risk of loss has as to nonconforming goods has passed to the buyer upon the buyer's acceptance of the goods and the goods are damaged or lost before the buyer effectively revokes acceptance, the seller has the risk of loss to the extent that the nonconformity of the goods caused the damage or loss.

(4) If conforming goods are identified to the contract when the buyer repudiates or is otherwise in breach and the risk of loss has not otherwise passed to the buyer, the buyer has the risk of loss for those goods for a commercially reasonable time after the breach or repudiation.

(e) This section is subject to Section 2-506(b) and (c).

Notes

1. This alternative focuses on two factors as relevant to the passage of risk of loss (in the absence of agreement to the contrary), conformity of the goods and possession or control of the goods. This alternative is more in line with the working of former §2-509 and §2-510 but eliminates the provisions regarding insurance coverage as irrelevant to the risk of loss. Who has an insurable interest will be determined by other law and not by this risk of loss rule. Cf. §2-502. This alternative continues the contract focus of risk of loss passage. Under a contract approach to risk of loss, the operative question is whether the seller has rendered the required quantum of performance so that it is fair for the risk of loss for the goods has passed to the buyer. This is in contrast to the title approach to passage of the risk which focused on when sufficient property rights had passed to the buyer in order for the risk to pass. See Robert L. Flores, *"Risk of Loss in Sales: A Missing Chapter in the History of the U.C.C.: Through Llewellyn to Williston and A Bit Beyond,"* 27 Pac. L.J. 161 (1996). The basic thrust in this alternative is that the seller who tenders non-conforming goods has not rendered enough performance for the risk of loss to pass to the buyer.

2. Subsection (d) states the exceptions to that general rule. Assume the seller tenders non-conforming goods, buyer takes possession of the goods but has not accepted the goods and the goods are destroyed. Seller has the risk of loss. Subsection (a). If the buyer accepts the goods, even though non-conforming, the risk passes to the buyer. Subsection (d)(1). If the buyer thereafter rightfully and effectively revokes acceptance, the risk passes back to the seller when the revocation is effective. Subsection (d)(2). As in the Note 5 under the alternative version of 2-612, this is necessary to make the risk of loss rule work in conjunction with the remedies for breach that the buyer has and the buyer's limited obligation under §2-714. Because the risk cannot pass to the buyer if the goods are not conforming until acceptance, there need not be any special provision for the risk passing back to the seller upon a rightful and effective rejection. Under subsection (d)(3), if prior to the revocation, the nonconformity causes the loss, the risk of that loss is on the seller. Finally under (d)(4), the issue is whether it is unfair for the buyer to prevent passage of the risk and thus the seller should be given access to the price remedy if destruction happens within a reasonable time after repudiation or breach by the buyer.

3. This section is consistent with §2-822. Risk of loss as to conforming goods can pass to the buyer when the applicable time is reached under subsections (a) through (c). If the buyer effectively but wrongfully rejects and the seller retains or regains possession of the goods, the buyer in effect retains the risk of loss if the goods are destroyed within a reasonable time after the risk passed to the buyer. If more than a reasonable time has passed, the risk in effect transfers back to the seller as the buyer is no longer liable for the price. §2-822.

PART 7

BREACH, REPUDIATION, AND EXCUSE

SECTION 2-701. BREACH OF CONTRACT GENERALLY; SUBSTANTIAL IMPAIRMENT.

(a) Whether a party is in breach of contract is determined by the terms of the contract.

(b) A breach of contract 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, or repudiates the contract.

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

(c) To determine whether the value of an installment or the whole contract have been substantially impaired by a breach of contract under Section 2-708, 2-712, 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 permitted and likely;
- (3) adequate assurance of due performance has been given; and
- (4) the breaching party acted in good faith.

(d) The cumulative effect of individual, unsubstantial breaches of contract may substantially impair the value of the whole contract to the other party .

SOURCE: Sales, Sections 2-703, 2-711; Licenses, Section 2B-108(a).

Notes

1. Section 2-701 brings the definition of breach previously found in §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 §§2-815 and 2-823. The word "default" is not used in Article 2. Terms of the contract include the parties' agreement and the rules from this article, 1-201(11), including the events listed in subsection (b).

Breach includes a failure to pay before or after acceptance. If the failure to pay after acceptance is also a default under a security agreement, Article 9 applies to the extent that the seller or other secured party attempts to enforce the security interest.

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., §§2-714 through 2-717.

3. Subsection (c) has been revised to delete the "material breach terminology and rephrase with the term "substantial impairment. Given the reaffirmance of the perfect tender rule and the decision to not cover service agreements, the concept of breach of the whole contract in article 2 is relevant only to the installment contract situation. "Substantial impairment", however, is relevant in Sections 2-708(a) and 2-712(a). The substantial impairment factors are taken from Restatement (2nd) Contracts §241. Two factors from that section that are not reflected above are the extent to which the injured party can be compensated for the deprived benefit and the extent that the party to perform will suffer forfeiture. Should those factors be listed?

SECTION 2-702. WAIVER OF BREACH; PARTICULARIZATION OF NONCONFORMITY.

(a) Except as otherwise provided in this section, a party that knows that the other party's performance constitutes a breach of contract but accepts that performance and fails within a reasonable time to object is precluded from relying on the breach to cancel the contract. However, acceptance of that performance and failure to object do not preclude a claim for

damages unless the party in breach has changed its position reasonably and in good faith in reliance on the aggrieved party's inaction.

(b) Payment against documents made without reservation of rights waives the right to recover the payment for defects apparent on the face of the document.

(c) Failure to object to a nonconforming performance under subsection (a) does not foreclose objection to the same or similar breach of contract in future performances of like kind unless the party foreclosed expressly so states. A statement waiving future performance may be retracted by seasonable notification received by the other party that strict performance will be required unless the waiver has induced the other party to change its position reasonably and in good faith.

(d) A buyer's failure to state, in connection with a rejection under Section 2-703 ~~or a revocation of acceptance under Section 2-709~~, 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 a breach of contract if:

(1) the seller, upon a seasonable particularization, had a right to cure under Section 2-709 and would [could] have cured the nonconformity; or

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

SOURCES: Sales, Section 2-605; Licenses, Section 2B-620 .

Notes

1. Subsections (a) and (c), which are new, are based upon 2B-619 (January, 1997). It operates between the waiver or renunciation of a claim for breach in 1-107 and the acceptance of an allegedly nonconforming performance under explicit reservation of rights in 1-207(1). It also complements 2-210, dealing with agreed modifications and waivers of terms in the contract for sale. Further coordination may be needed.

The line between waiver of a term under §2-210 and waiver of a breach of a term may be a fine line in some cases. The difficulty can be illustrated as follows. Assume Seller agrees to provide delivery in 12 monthly installments starting on Jan 15. The contract does not include a

no oral modification clause. Seller delivers on Jan. 20. Buyer accepts that performance without objection. If Buyer's actions are construed as waiver of the delivery term of Jan. 15, delivery on Jan. 20 is not a breach of contract as long as it is delivery within a reasonable time under the gap fillers. If Buyer's actions are construed as a waiver of the breach, under proposed §2-710(a), Buyer's failure to object prevents Buyer from canceling the contract but does not preclude Buyer's damage claim for late delivery unless Seller has reasonably changed its position in good faith and in reliance on a party's inaction. It is extremely difficult to tell from Buyer's actions whether Buyer intended to waive the term or the ability to cancel the contract for the breach. In the absence of a statement by Buyer that Seller need not conform to future agreed installments and reliance by Seller, however, Buyer's conduct should be treated as a waiver of breach. See 2-210(d).

Section 2-210(d) and § 2-702(c) provide the same rule as to retractions of waivers of future performance.

2. The preclusion in subsection (a) is limited to the remedy of cancellation. Notice for the remedy of revocation of acceptance is stated in §2-708(b). Moreover, a claim for damages resulting from an accepted nonconforming performance may be barred under §2-707(1)(c). The notice required in subsection (a), however, should also satisfy the notice requirements of §2-707(1)(c).

To illustrate, suppose the seller has agreed to deliver the goods in 12 monthly installments and the parties have agreed that no modification of the contract terms shall be enforceable unless contained in a signed record. The seller meets the first six installments but is late in the next three, which the buyer accepted without objection. Later, the buyer insisted that the seller deliver the final three installments on time. Subsection 2-702 rather than 2-210 applies to this dispute. Unless the buyer has given reasonable notice of objection to the delay, the remedy of cancellation is barred under subsection (a) and the damage remedy for the three installments may be barred under 2-707(c)(1). However, nothing on the facts supports the seller's claim that timely, future performance has been waived.

3. Subsection (d) is taken from §2-605 of the 1990 Official Text. The move places it in closer proximity to the general notice required for an effective rejection, §2-703(b and places it in the context of the general waiver standard in subsection (a).

4. This section on waiver of breach is an attempt to answer three questions. First, in what circumstances must the aggrieved party notify the breaching party or be deemed to have waived the nonconforming performance. Second, in those circumstances where the aggrieved party must notify the breaching party, what must that notice say, i.e. how particular and complete must that notice be. Third, if the notice is required and not given, or if notice is given but not particular or complete enough, what is the effect of the aggrieved party's failure. A fourth question that this section does not answer but which must be considered is whether this section is an explicit displacement of common law waiver and estoppel that would otherwise be very relevant to resolving those questions.

Assume that the buyer is the aggrieved party. The buyer must notify the seller in three situations, when rejecting goods, when revoking acceptance of goods, and as a prerequisite to recovery for breach when goods have been accepted.

When the buyer rejects goods, subsection (d) specifies the circumstances where the buyer must state defects or be unable to rely on those defects either to justify rejection or to establish a breach of contract. Subsection (d) is the same as former §2-605(1).

When the buyer revokes acceptance of the goods, the buyer must give notice to the seller. Should the buyer have to particularize defects in that notice of revocation and what defects should be particularized? If the buyer is required to particularize defects justifying the revocation, subsection (d) in that situation does not seem to make much sense. A seller can only revoke acceptance in two situations: first if the buyer had the reasonable assumption that the nonconformity could be cured and second if the nonconformity was not discovered due to difficulty of discovery before acceptance or the seller's assurances. In the first situation, the buyer could not have the reasonable assumption of cure unless there had been some particularization of the defect before the acceptance. The reasons for particularization stated in (d)(1) has already been met. In the second situation, having to state reasonably ascertainable nonconformities when the nonconformity for which one is revoking was not discovered prior to acceptance due to difficulty of discovery seems illogical. Nonetheless, there could be a situation not covered by subsection (d) where nonconformities substantially impair the value to the buyer sufficient to justify revocation and where the seller has a right to cure. In that situation, there may be some utility to requiring the buyer to fully particularize the nonconformities which justify revocation. Obviously, this depends upon the extent to which cure is expanded in the revocation context.

In the revocation context, should the buyer be required to particularize nonconformities that do not substantially impair the value of the contract to the buyer or be barred from "establishing breach (language currently in subsection (d)) as to those nonconformities? Is there some reason to require particularization of those types of "insubstantial nonconformities in the revocation situation when such a detailing is not required when the buyer is claiming breach as to accepted goods under §2-707? It seems unfair to penalize the buyer who seeks to revoke for not stating nonconformities that do not support the revocation.

Finally, the buyer has to give notice when the buyer has accepted goods and the buyer wants to recover for breach of contract. While there is some debate in the cases about how particular that notice has to be, the standard in subsection (d) does not apply as it is a rejection only standard, and the standard in subsection(a) is not particularly helpful as the only consequence of failing to object is the inability to cancel or to sue for damages if the breaching party has changed position in reliance on the failure to object. In the accepted goods context, cancellation is not generally an option and the changed position standard merely echos the need to establish prejudice in failing to give the notice. Neither this section or §2-707 require any degree of particularization of the nonconformities. or any inference that the nonconformities stated are the only ones the buyer is asserting. If the drafting committee wanted to require the buyer to particularize all nonconformities in order to have a remedy in the accepted goods situation, this section or §2-707 could provide the place to do so.

When the seller is the aggrieved party, subsection (a) states the effect of failing to object to the buyer's nonconforming performance and the penalty for failing to object. Again, a standard of particularization for the nonconformity is not stated nor is there any inference that the objected to performance is the only nonconformity upon which the seller proposes to rely.

5. **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 Art. 39(2), Art. 40 and Art. 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 2-703. BUYER'S RIGHTS ON NONCONFORMING DELIVERY;
RIGHTFUL REJECTION.**

(a) Subject to Sections 2-603(b), 2-710, 2-809, and 2-810, 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 units and reject the rest.

(b) A rejection under subsection (a) is not effective unless the buyer notifies the seller within a reasonable time after tender of delivery [the nonconformity was or should have been discovered].

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

Notes

1. Revised §2-703(a) states when the buyer can reject a non-conforming tender and §2-703(b), previously found in former §2-602(1), requires timely notice for an effective rejection. A rejection not permitted under §2-703(a) is wrongful and a breach, see §§2-701(a)(1) and 2-815, even though prompt notice is given. A rejection that is rightful under §2-703(a) but not effective under §2-703(b) may be an acceptance under §2-706(a)(2).

The first rephrasing in subsection (b) is to make sure that the effectiveness of the notice is from when the buyer sends it under 1-201(26). The second rephrasing is to highlight the issue of when the time for notice should start to run. Former §2-602(1) stated that rejection must take place within a reasonable time after tender or delivery. If the reasonable time does not start to run until the nonconformity was or should have been discovered, the buyer has very little incentive to discover quickly the non-conformity and the courts will have to resolve in each case when the nonconformity should have been discovered.

The drafting committee needs to make a policy choice here as to when the reasonable time for making an effective rejection should start to run.

2. Subject to various limitations stated in §2-703 and elsewhere, §2-703(a) preserves the perfect tender rule. Section 2B-609(a) (Sept. 1996), however, requires a material breach. There are 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. Sections 2-809 and 2-810(a). In addition, because the "contract incorporates usage of trade, course of dealing and course of performance, the

ability to state that the goods don't conform to the contract will be limited by the facts relevant to those concepts. Further, the power to reject is limited by §§2-603(b) and 2-710, both of which require non-conformity of a more substantial nature.

Another statutory limitation is §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. §2-706(a)(2). To revoke acceptance under §2-708, 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 power to "cure" under revised §2-709. 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 and the seller has a right to cure under §2-709 will not be able to cancel the contract until the seller has had a reasonable opportunity to cure.

3. **CISG.** Under CISG, buyer remedies are triggered when the seller "fails to perform any of his obligations under the contract," Art. 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 Art. 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 unless the buyer can avoid the contract under Article 49.

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 Art. 75 unless the contract is avoided for fundamental breach.

SECTION 2-704. EFFECT OF RIGHTFUL REJECTION AND JUSTIFIABLE REVOCATION OF ACCEPTANCE.

(a) Subject to Sections 2-705 and 2-823(c), after an effective rightful rejection or justifiable revocation of acceptance, a buyer that takes delivery shall 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 an effective 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 reasonable under the circumstances and is not an acceptance, the buyer, upon returning or disposing of the goods, shall 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 which wrongfully but effectively rejects but does not accept goods is subject to subsection (b)(1) and the duty of care in subsection (a).

SOURCE: Sales, Sections 2-603 and 2-604.

Notes

1. Subsection (a), which was subsection (2) in an earlier draft, is taken from §2-602(2)(b) & (c) of the 1995 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 that is effective under §2-703 or §2-708. That duty of care also applies when a buyer is in possession of wrongfully rejected but not accepted goods, i.e., a buyer who had no ground for rejection under §2-703(a) but effectively rejected under §2-703(b). See §2-704(c).

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. A buyer who rightfully but ineffectively rejects also may be treated as accepting the goods under §2-706(a)(3) and would be liable for the price. §2-822.

2. Subsection (b)(1) is taken from §2-602(2)(a) of the 1995 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 §2-706(a)(4) 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. Another possible measure of value, not stated in the text, is what it would cost the buyer to obtain a comparable use from a person in the seller's position. See Restatement, (Second) Contracts §371(a). But the seller may deduct that use value from the sum of ant price paid to the seller and any damages otherwise resulting from the breach. See §2-823(a), which permits the buyer to recover these amounts. See also, Note, *Article 2: Revocation of Acceptance. . . Should a Seller be granted a Set off for the Buyer's Use of Goods*, 30 N. Eng. L. Rev. 1073 (1996).

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 for the use 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 §2-806.

4. Subsection (c) does not apply to a buyer who unjustifiably revokes acceptance because the buyer has already accepted goods to which title has passed and owes the price. A buyer who attempts to revoke acceptance, however, bears the loss of goods not properly cared for if a court subsequently holds that the revocation was justified.

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

SECTION 2-705. MERCHANT BUYER'S DUTIES; BUYER'S OPTIONS AS TO SALVAGE.

(a) Subject to a buyer's security interest under Section 2-823(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 an effective rightful rejection or justifiable 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 such instructions shall make a reasonable effort to sell or otherwise dispose of the goods 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 that 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 a rightful rejection or justifiable revocation of acceptance, a merchant buyer or nonmerchant buyer, 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 this section, 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 a claim for damages.

SOURCE: Sales, Section 2-603.

Notes

1. Section 2-705 integrates in one section various strands of the buyer's post rejection and revocation duties with regard to the goods not otherwise covered in §2-704. 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 §2-603(1), and subsection (b), taken from §2-603(2), are limited to merchant buyers. Subsection (c), taken from §2-604, and subsection (d), taken from §2-603(3), apply to all buyers. See 2B-611 (Jan. 1997), stating the licensee's duties following a rightful refusal of a defective tender.

The language added to subsection (c) is intended to clarify that a non-merchant buyer need not follow late instructions given by the seller.

2. CISG. See Articles 86-88.

SECTION 2-706. WHAT CONSTITUTES ACCEPTANCE OF GOODS.

(a) Goods are accepted if the buyer:

(1) states to the seller at any time that the goods are accepted;

(2) 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;

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

(4) either before or after rejection or after 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 a commercial unit is acceptance of the entire unit.

SOURCE: Sales, Section 2-606.

Notes

1. Section 2-706 (former §2-606) states what constitutes an acceptance of goods by the buyer.

Under subsection (a)(2), 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)(3), the buyer must first have a reasonable opportunity to inspect the goods and then fail to make an effective rejection under §2-703(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. The rejection was rightful under §2-703(a) but not effective under §2-703(b). Conversely, it is not an acceptance where the buyer effectively rejects for reasons not permitted under §2-703(a). Unless the buyer does an act of unreasonable ownership or control over the goods, see subsection (a)(4), a wrongful but effective rejection is a breach under §2-701 but not an acceptance under §2-706.

Does this make sense? Why not state simply and clearly that a wrongful rejection under §2-703(a), even though effectively communicated under §2-703(b), is an acceptance. An effective but wrongful rejection gives rise to the seller's action for breach of contract damages. If an effective but wrongful rejection is treated as an acceptance, the seller would have an action for the price.

Subsection (a)(4) 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. This section must be read in conjunction with §2-704(b) which provides in effect that reasonable acts that may be inconsistent with the seller's ownership may not be an acceptance although the buyer will have to compensate the seller for the reasonable value of the buyer's use of the goods.

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

SECTION 2-707. 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 price 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 of contract, shall notify the party claimed against of the breach. However, a failure to give notice bars the buyer from a remedy only to the extent that the party entitled to

notice establishes that it was prejudiced by the failure.

(2) If a claim for infringement or the like is made against a buyer for which a seller is answerable over, the buyer shall 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 of contract with respect to goods accepted.

(e) In a claim for breach of a warranty, indemnity, or other obligation against the buyer for which another party is answerable over, the following rules apply:

(1) The buyer may give notice of the litigation to the other party in a record, and the person notified may then give similar notice to any other person that is answerable over. If the notice invites the person notified to intervene in the litigation and defend and states that failure to do so will bind the person notified in any action later brought by the buyer as to any determination of fact common to the two actions, the person notified is so bound unless, after reasonable receipt of the notice, the person notified 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 reasonable receipt of the demand, control is turned over to the seller.

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

SOURCE: Sales, Section 2-607.

Notes

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

(a) Delete "materially" from §2-707(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. Presumably, the failure to notify must prejudice the seller's efforts to inspect the goods, preserve other evidence or prepare for settlement or trial. The burden to establish prejudice is on the seller.

(b) Restore the original language in §2-607(3)(b) to revised Section 2-707(c)(2). The "prejudice" limitation was rejected for infringement claims.

(c) Replace "prove" with "establish" in §2-707(d), since "establish" is defined in §1-201.

(d) Clarify the relationship of the parties in the "vouching in" provision, §2-707(e)(1). See subsection (e)(1). The Drafting Committee has rejected a suggestion that the "vouching" provision be deleted.

2. The word "contract" has been inserted in subsection(a) to make clear that the buyer is obligated to pay the contract price as opposed to the market price for the goods. The word "buyer" has been substituted in subsections (b)(2) and (e)(1) to make clear that these obligations apply to a buyer who has accepted goods. To the extent that the Drafting Committee thinks that any part of the concept of this section regarding vouching in should apply when someone else other than a buyer who has accepted goods is sued, then those provisions should probably be located in the code in the context of those other rights and not placed in this section.

3. Notice by the buyer to the seller is important in three situations involving remedies: First, to make an effective rejection under §2-703(b); Second, to revoke acceptance under §2-708(b); and Third, to preserve a damage remedy for accepted goods under §2-707(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 §2-702(d). In the second case the notice should state that the buyer is revoking acceptance and the limited grounds for possible cure, see §2-708(b). But see note 4 after 2-702. In the third case the notice need state only that the buyer is claiming a breach, see §2-707(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.

See the notes following §2-702 for issues posed by the requirements to give notice.

3. **CISG.** Although the buyer is obligated to take delivery and pay the price "as required by the contract and this Convention," Art. 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 2-708. 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 the lot or unit was 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 that justifiably revokes acceptance has the same rights and duties under Sections 2-704 and 2-705 with regard to the goods as if they had been rejected.

SOURCE: Sales, Section 2-608.

Notes

1. There are no revisions of substance in §2-708 (formerly §2-608). Under §2-709(a), however, the seller now has power to cure a nonconformity when acceptance is revoked under subsection (a)(2). See notes after §2-702 for issues regarding what the notice must say in the accepted goods context.

2. Notes: (1) For when a breach substantially impairs the value of the lot or commercial unit to the ~~other~~ buyer, see §2-701(c); (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 §2-810.

3. Upon a justifiable revocation of acceptance under subsection (a)2, the seller has a right to cure as defined in §2-709. Note, however, that §2-708(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 §2-709.

SECTION 2-709. CURE.

(a) Subject to subsection (d), if a buyer rightfully and effectively rejects a tender of delivery under Section 2-703 or justifiably revokes an acceptance under Section 2-708(a)(2) and the agreed time for performance has not expired, the seller, upon seasonable notice to the buyer and at its own expense, may cure any breach by making a conforming tender of delivery within

the agreed time.

Alternative A

(b) Subject to subsection (d), if a buyer rightfully rejects goods or a tender of delivery under Section 2-703 and if the agreed time for performance has expired, the seller upon reasonable notice to the buyer and at its own expense, may cure a breach by making a tender of conforming goods within a reasonable time if such tender does not substantially impair the value of the contract to the buyer.

Alternative B

(b) Subject to subsection (d), if a buyer rightfully rejects goods or a tender of delivery under Section 2-703 and the agreed time for performance has expired, the seller may cure if cure is appropriate and timely under circumstances and the buyer has no reasonable grounds to refuse the cure.

(c) Subject to subsection (d), if a buyer has justifiably revoked acceptance under 2-708(a)(2) and if the time for performance has expired, the seller upon reasonable notice to the buyer and at its own expense, may cure any breach by making a tender of conforming goods within a reasonable time if such ~~retender~~ cure does not cause further substantial impairment of the value of the contract to the buyer.

(d) To cure a breach, the seller shall compensate the buyer for all of the buyer's reasonable and necessary expenses caused by the nonconforming tender and the cure.

SOURCE: Sales, Section 2-508; Unidroit Principles, Art. 7.1.4.

Notes

1. The November 1996 draft of Section 2-710, which is was taken from Art. 7.1.4 of the Unidroit Principles, both expanded and simplified the seller's cure opportunity. This Section was approved in principle by the Drafting Committee at the March, 1996 meeting and minor changes were recommended at the September, 1996 meeting. At the November 1996 meeting the drafting committee voted to follow the approach outlined above. At the January 1997 meeting, the committee voted for Alternatives A of subsections (b) and (c) and for the principle stated in subsection (d).

2. This draft of §2-709 is an attempt to respond to the discussion of the drafting committee at the January 1997 meeting. Cure under this section concerns curing the breach of contract that the seller committed by making a non-conforming tender. If the seller cures under

this section, there is no breach of contract. The buyer has no ability to get a remedy under this article without a breach of contract by the seller. If the seller does not cure under this section, then the seller is in breach of contract and the buyer may resort to its remedies. If the seller has a right to cure under this section (which assumes the seller is able and willing to comply completely with the section requirements) and the buyer prevents the seller from curing, the buyer, not the seller, has breached the contract. In that scenario, the seller would be entitled to pursue remedies for breach of contract. This section can be looked at as providing the seller a checklist of the actions it must take to avoid being in breach of contract once nonconforming tender of delivery has been made. With those basic points in mind, the specific subsections work as follows:

Subsection (a) allows a cure to be made by a conforming tender of delivery before the time for performance has expired in cases where the buyer has rejected and in cases where the buyer has revoked acceptance. That expands former §2-508(1) to the revocation of acceptance situation. This cure consists of a conforming tender of delivery and must be made upon reasonable notice to the buyer, at the seller's own expense, and within the time for contract performance. In addition, the seller must compensate the buyer for any of the buyer's reasonable and necessary expenses caused by the nonconforming tender and the cure. Subsection (d). Only if all of those conditions are satisfied will the seller's actions cure the breach of contract that it created by initially making a non-conforming tender.

To illustrate the operation of subsection (a), consider the following example: S and B agree that S will deliver goods according to contract specifications on Jan. 15. S actually delivers the goods on Jan. 10 and the goods do not conform to contract specifications. B effectively and rightfully rejects the goods under §2-703. For S to cure under §2-709(a), the S must give reasonable notice to B, must compensate B for any of the B's reasonable expenses caused by the non-conforming tender and attempted cure, must bear S's own expenses, and must make a completely conforming tender no later than Jan. 15. The concept of reasonable notice under subsection (a) incorporates the idea of determining what is reasonable from the buyer's perspective, focusing on whether the buyer has reasonably changed position in good faith reliance on the non-conforming tender. See Hawkland, §2:508:2. Assume that B accepts, instead of rejects, the non-conforming goods, and then subsequently effectively and justifiably revokes acceptance under §2-708(a)(2). S would be able to cure if it satisfies all of the conditions stated above.

Subsection (b) addresses cure when the time for performance has expired and the buyer has rejected the goods. Former §2-508(2) allowed a seller to cure if the seller had reasonable grounds to believe that the tender would be acceptable. Under former § 2-508(2) some of the issues that had arisen in the cases are rejecting for minor defects, surprise rejections and unknown defects. Bad faith rejections are already dealt with under the perfect tender rule as stated in § 2-703 and the concept of good faith in making that rejection. Usage of trade, course of performance and course of dealing are already incorporated into the concept of conformity to the "contract. At the January 1997 meeting, the committee voted for Alternative A stated above. Again, subsection (b) provides a checklist for the seller to determine what the seller must do to cure the breach it caused by making a nonconforming tender of delivery. If the buyer rejects the nonconforming tender, the seller must give a reasonable notice to the buyer, must bear the seller's own expenses in making the cure, must tender conforming goods, the tender of conforming goods must take place within a reasonable time, the tender of conforming goods must not substantially impair the value of the contract to the buyer, and the seller must compensate the buyer for all of the buyer's reasonable and necessary expenses caused by the nonconforming tender and the proffered cure. Again whether the notice is given seasonably to the buyer and whether the cure has been made within a reasonable time must be judged from the

buyer's perspective.

The time of the attempted cure not the time of the initial performance relative to the agreed time for performance under the contract determines whether subsection (a) or subsection (b) applies. To illustrate, assume Seller agrees to tender goods according to the contract specifications on Jan. 15. Seller tenders non-conforming goods on Jan. 14. Buyer effectively and rightfully rejects on Jan. 15. If Seller's attempted cure takes place on Jan. 15, Seller's actions are judged under subsection (a) as to whether the attempted cure in fact is sufficient to cure the breach. If Seller's attempted cure takes place on Jan. 16, Seller's actions are judged under subsection (b). Assume instead that Seller tenders non-conforming goods on Jan. 16. Buyer effectively and rightfully rejects on Jan. 17. Seller's attempted cure will be judged under subsection (b).

Assume that the Seller tendered goods on Jan. 16 and the only reason for Buyer's rejection was that the tender was late. Subsection (b) would apply. In that situation, if the late delivery substantially impaired the value of the contract to the buyer, the seller could not cure. If the late delivery does not substantially impair the value of the contract to the buyer, then the seller's tender, if still being made, and if all of the other conditions stated were satisfied, would cure the breach caused by the original late tender. Query whether this situation is adequately addressed by a rule that a rejection must be in good faith. Is a buyer acting in good faith to reject an otherwise conforming tender on grounds of lateness if timeliness is not important to the buyer?

Alternative B, suggested by Professor Richard Hyland in a Memo, dated January, 1997, provides a simplifying contrast.

Subsection (c) deals with the situation where the time for performance has expired and the buyer has revoked acceptance under §2-708(a)(2).. In that situation, to effectively revoke, the original tender must be nonconforming, the nonconformity must substantially impair the value of the contract to the buyer and the nonconformity must not be discovered prior to acceptance because it was difficult to discover or acceptance was induced by the seller's assurances. Once the buyer revokes, subsection (c) gives the seller an opportunity to cure if the seller gives reasonable notice to the buyer, the seller bear its own expenses, the cure is of conforming goods, the cure takes place within a reasonable time, the seller compensates the buyer for its reasonable and necessary expenses caused by the nonconforming tender and attempted cure, and the cure does not cause further substantial impairment of the contract to the buyer. The same points about testing reasonable notice and reasonable time from the buyer's perspective would also control here. In addition, the timing issue discussed above of the cure relative to the agreed time for performance would also be true in this context.

In both subsections (b) and (c), the idea of substantial impairment of the value to the buyer is intended to pick up the "shaken faith" idea that the buyer's faith in the product may be so compromised by what has happened that the seller will not be allowed to cure.

Under this approach, the following questions remain: (1) Is there any substantive difference between subsections (b) and (c) other than the difference between rejection and revocation? Could these two subsections be combined? (2) In the revocation context, is there a difference between the substantial impairment necessary to revoke and the substantial impairment caused by the cure? (3) Does the concept of conforming goods in subsections (b) and (c) pick up issues like the quantity of goods and other non-quality related contract requirements? (4) Under current §2-508, some courts and commentators argue that goods can be made

conforming by repair. Is that idea disapproved and if so, does the draft capture that disapproval?

3. The problem of cure in installment contracts, §2-710 (previously treated in §2-612(2) of the 1990 Official Text), is treated in §2-710. 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.

4. Note that a rejection must be rightful under §2-703(a) and effective under §2-703(b) before §2-709 becomes operative. The phrase "rightful rejection" is used to signal a proper rejection. A wrongful rejection is a breach of contract, see §2-701, and an ineffective rejection is an acceptance. If the cure is ineffective, the buyer may pursue its remedies under §2-823(1), including cancellation.

The buyer breaches if it deprives the seller of its statutory right to cure under §2-709 or fails to cooperate in good faith when the seller attempts to cure. See §2-307. Thus, if the buyer had a right to reject under §2-703(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 Art. 49(1)(a) and Art. 25.

Article 37 deals with Seller's cure where nonconforming goods are delivered "before the date for delivery. Seller may cure "up to that date" if the "exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. Buyer retains any right to claim damages.

Article 48(1), which does not apply if the contract is avoided for fundamental breach under Art. 49, gives a right to cure "even after the date for delivery. Seller may "remedy at his own expense any failure to perform his obligations, if he can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty or reimbursement by the seller of expenses advanced by the buyer. Again, Buyer retains any right to claim damages.

5. UNIDROIT PRINCIPLES. Article 7.1.4 provides:

- (1) The non-performing party may, at its own expense, cure any non-performance, provided that
- (a) without due delay, it gives notice indicating the proposed manner and timing of the cure;
 - (b) cure is appropriate in the circumstances;
 - (c) the aggrieved party has no legitimate interest in refusing cure; and
 - (d) cure is effected promptly.
- (2) The right to cure is not precluded by notice of termination.
- (3) Upon effective notice of cure, rights of the aggrieved party that are inconsistent with the non-performing party's performance are suspended until the time for cure has expired.
- (4) The aggrieved party may withhold performance pending cure.
- (5) Notwithstanding cure, the aggrieved party retains the right to claim damages for delay as well as for any harm caused or not prevented by the cure.

SECTION 2-710. INSTALLMENT CONTRACT: BREACH.

(a) In this section, "installment contract" means an agreement in which the terms require or the circumstances permit the delivery of goods in lots to be separately accepted, even if the agreement requires payment other than in installments or contains a term stating "Each delivery is a separate contract" or words of similar import.

(b) A buyer may reject any nonconforming installment of delivery of goods [or documents] in an installment contract if the nonconformity substantially impairs the value of that installment to the buyer [or if the nonconformity is a defect in the required documents]. [However, if a nonconforming tender by the seller is not a breach of the whole contract and the seller gives adequate assurance of its cure, the buyer shall accept that installment.]

(c) If a nonconformity with respect to one or more installments in an installment contract is a substantial impairment of the value of the whole contract, there is a breach of the whole contract and the aggrieved party may cancel the contract. 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 giving notice of cancellation, brings an action with respect to only past installments, or demands performance as to future installments.

SOURCE: Sales, Section 2-612.

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." §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. After the July, 1996 Draft, Subsection (b) was revised to exclude nonconforming installment payments by the buyer. Although a nonconforming installment payment is a breach, see 2-701(b)(2), the seller does not have power to reject it under subsection (b). The seller can, however, demand adequate assurance of due performance under §2-711 and to withhold future deliveries under 2-815(1). The seller can also cancel the contract under subsection (c) if the failure to pay one or more installments is substantially impairs the value of the whole contract. §2-701(c).

Unlike breach by the seller, the buyer has no statutory right to cure a breach in payment. Realistically, the seller will probably accept a late or deficient payment and reserve rights to

damages or cancellation under §1-207. Cf. §2-702 regarding waiver of breach. Allowing delays or deficiencies to cumulate may result in a breach of the whole contract under §2-701(d).

The bracketed language in subsection (b) is to call attention to the change from former §2-612(2). The issue is whether a defect in documents should be tested under the substantial impairment test or tested by a stricter performance standard. The phrasing of former §2-612(2) suggested that a defect in documents was tested by a stricter standard than substantial impairment.

To illustrate the operation of this section with the definition of substantial impairment in §2-701(c), consider the following hypothetical. Seller delivers the first installment of goods under the installment contract. The goods do not conform to the contract. The seller has breached the contract. Section 2-710(b) precludes the buyer from rejecting that installment if the nonconformity does not substantially impair the value of that installment. To determine that substantial impairment issue as to that installment, the factors in §2-701(c) are consulted. Two of the four factors listed in subsection (c) are cure and adequate assurance. If the nonconformity results in substantial impairment of the value of that installment, almost by definition, cure is not likely and adequate assurance of due performance has not been given. In that situation, the buyer can reject that nonconforming installment. Conversely, if the seller gives adequate assurance of cure and cure is likely, the nonconformity does not substantially impair the value of that installment and the buyer cannot reject it. Prior to substantial impairment being defined in the Code, the last sentence of §2-710(b) was important to get the court to focus on the key elements of finding substantial impairment. The definition in §2-701 (c) of substantial impairment might make the last sentence of §2-710(b) unnecessary. The utility of retaining the last sentence of §2-710 (b) is to isolate two of the substantial impairment factors in the installment context as being more important than the other factors in finding no substantial impairment has occurred.

3. Under subsection (c), the seller or the buyer may cancel an installment contract if breach by the other amounts to a breach of the whole contract. Breach of the "whole" is defined in 2-701(c) in terms of substantial impairment of the value of the contract to the plaintiff. 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. §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 §2-702 dealing with "waiver" of a breach by failing to object. A material breach substantial impairment of the value of an installment may be a breach of the "whole" contract. §2-701(c). If so, the remedy of cancellation is available. See 2-815(8) & 2-823(a)(2).

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 Art. 25. The concept is consistent with §2-710 but the terminology is somewhat different.

SECTION 2-711. 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 party 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 under Section 2-712(a).

SOURCE: Sales, Section 2-609.

Notes

1. There are no revisions in Section 2-711 [formerly 2-609]. Subsection (c) states that acceptance of a past nonconforming performance does not preclude the ability to demand adequate assurance of future performance. Section 2-702(c) provides that failure to object to a past breach does not preclude objecting to future breaches. These two subsections address two different aspects of accepting nonconforming performance.

2. CISG. See Article 71(a), which recognizes a more limited principle of performance insecurity. A party suspending performance under Art. 71(a) must notify the other party "immediately" and must continue with performance "if the other party provides adequate assurance of his performance." Art. 71(3).

SECTION 2-712. ANTICIPATORY REPUDIATION.

(a) If either party to a contract repudiates a performance not yet due and the loss of performance will substantially impair the value of the contract to the other party, the aggrieved party may:

(1) await performance by the repudiating party for a commercially reasonable time or resort to any remedy for breach of contract, 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

(2) in either case under paragraph (1), suspend its own performance or, if a seller,

proceed in accordance with Section 2-817.

(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.

SOURCE: Sales, Section 2-610.

Notes

1. Revised §2-712 (formerly §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 §2-711(d) (formerly §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 §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 "performance not yet due" can constitute a substantial impairment of the entire contract. See §2-710(c) (formerly §2-612). Such a substantial impairment is a breach of the whole contract. See 2-701(c).

2. **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," Art. 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." Art. 72(3). Adequate assurance presumably requires more than just a simple retraction of the repudiation.

SECTION 2-713. 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 the contract. However, a retraction must contain any

assurance demanded under Section 2-711.

(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.

Notes

1. There are no revisions in §2-713 (formerly §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, Art. 71(3), or intending to declare the contract avoided for a repudiation, Art. 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 2-714. CASUALTY TO IDENTIFIED GOODS. 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 and no commercially reasonable substitute is available, 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 price for the nonconformity but without further right against the seller.

SOURCE: Sales, Section 2-613.

Notes

1. The phrase "contract requires" in §2-613 of the 1990 Official Text has been replaced with the phrase "parties assume the continued existence of goods." Thus, if both parties intend the continued existence of identified goods, those goods are the equivalent of "specific goods. The language regarding commercially reasonable substitute is inserted for discussion to address the following scenario. Seller agrees to sell stock goods, those goods are identified and then destroyed. If the seller had other stock that was the commercially reasonable substitute for the identified goods, this section would not excuse the delivery. In part this narrows the excuse provided by this section back towards the original version of §2-613 which allowed an excuse

only when the “contract required for its performance goods identified when the contract was made.

Section 2-714 provides a default rule and applies only if the parties have not otherwise agreed. Thus, evidence relevant to whether the parties assumed the continued existence of identified goods should then be considered. For example, even if the contract contemplates but 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, §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 §2-324" is deleted, pursuant to the Drafting Committee's decision to delete §§2-319 - 2-324 from revised Article 2.

3. The notice requirement in §2-714(1) was added to achieve parity with §2-717(b)(2). The seller's defense is avoided if the notice required in paragraph (1) is not given.

4. Excuse for casualty to goods identified after contract formation is determined under §2-716.

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 §2-714(formerly §2-613).

SECTION 2-715. SUBSTITUTED PERFORMANCE.

(a) If, without the fault of either party, agreed berthing, loading, unloading facilities or 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 2-716 unless a commercially reasonable substitute is available. In that case, 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 which 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 2-614.

Notes

1. There are no revisions of substances in §2-715 (formerly §2-614).
2. **CISGA.** See Article 79(1).

SECTION 2-716. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Subject to Section 2-715 and subsection (b), delay in performance or nonperformance by the seller is not a breach of contract if the seller's performance as agreed has been made impracticable 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.

(b) A party claiming excuse under subsection (a) shall 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 shall also allocate production and deliveries among its customers in a manner that is fair and reasonable and notify the buyer of the estimated quota made available. However, the seller may include regular customers not then under contract as well as its own requirements for further manufacture.

SOURCE: Sales, Section 2-615.

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. The November, 1996 Draft of revised §2-717 (now 2-716) does not cover when the buyer's duty to accept and to pay for the goods is excused due to "frustration of purpose". See Restatement, Second, Contracts §265. The question is left for non-code law, which grants excuse in a narrow category of cases. See Comment 9 to former §2-615 and the case law.

3. The new comments to §2-716 will summarize the interpretative case law under former §2-615 and the “frustration doctrine. 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 2-717. PROCEDURE ON NOTIFICATION CLAIMING EXCUSE.

(a) A party that receives notification of a material or indefinite delay in performance or an allocation permitted under Section 2-714 or 2-716 as to any delivery concerned, or if there ~~which~~ is a breach of the whole contract under Section 2-710(c), by notification in a record, may:

- (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 2-714 or 2-716, 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 only to the extent that the parties have assumed a different obligation under Section 2-716.

SOURCE: Sales, Section 2-616.

Notes

1. Section 2-717 has been revised to provide for cases where the buyer notifies the seller of a material delay or non-performance in payment and to apply to the notice required under section 2-714 on specific goods. The word “different in subsection (c) as opposed to “greater from former §2-616 means that if the seller agrees to a lesser obligation or a greater obligation than that provided under §2-716, the parties can also agree that the buyer will have rights different than those provided in §2-717. If the seller is excused under the provisions of §2-716, however, the parties can not have agreed prior to the circumstances arising that the buyer would have different rights than under §2-717.

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 Art. 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 2-718. 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, on reasonable notification to the other party, 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 party.

(2) Parties to a sale 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.

Notes

There are no changes of substance to former §2-515.

PART 8

REMEDIES

[A. IN GENERAL]

SECTION 2-801. SUBJECT TO GENERAL LIMITATIONS. The remedies of the seller, buyer, and other protected persons under this article are subject to the general limitations and principles stated in Sections 2-801 through 2-814.

SOURCE: New.

Notes

1. Section 2-801 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 8. Some of these policies were expressed in §2-801 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. See Article 2B, Part 7.

Despite a recommendation by the Committee on Style that §2-801 be deleted as a superfluous "road map", the Drafting Committee, at the September, 1996 meeting, voted to retain it. The section directs that remedies under Part 8 are subject to the policies in subpart A.

2. **CISG.** Revised Part 8 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 prefers specific performance over damages and states applicable damage principles in general terms.

SECTION 2-802. BREACH OF CONTRACT; PROCEDURES. If a party is in breach of a contract, the party seeking enforcement:

(1) has the rights and remedies provided in this article and, except as limited by this part, in the agreement;

(2) may reduce its claim to judgment or otherwise enforce the contract by any available administrative or judicial procedure, or the like, including arbitration if agreed to by the parties; and

(3) may enforce the rights and remedies available to it under other law.

SOURCE: Licenses, Section 2B-701; Leases, Section 2A-501.

Notes

This section, which was §2-501 in the May, 1995 Draft, states the general remedial options available upon breach of contract. Breach is defined in §§2-701. 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 2-803. REMEDIES IN GENERAL.

(a) Subject to Section 1-106, 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. Unless the contract provides for liquidated damages or a limited remedy enforceable under Sections 2-809 or 2-810, a court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a substantially better position than if the ~~other~~ breaching 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 2B-701; Sales, Section 2-701.

Notes

1. The remedial policies in §2-803 are derived from §2-502 of the May, 1995 Draft and §2-801 of the May, 1994 Draft. The breaches which trigger these remedies are defined in §§2-701 and 2-710.

2. Subsection (a) directs the courts to protect the so-called "expectation" interest. This restates the principle in §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 §2-804.

3. Subsection (b) states a general mitigation of damages requirement and is consistent with CISG Art. 77. It supplements the mitigation principles built into particular remedy sections of Part 7, see, e.g., §§2-806 and 2-817, 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 §2-819(a) on resale, or enforces an agreed remedy, such as liquidated damages, is not subject to subsection (b). 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 a 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 [including an arbitral tribunal], if requested by the defendant, may deny a particular choice when that remedy under the circumstances puts the aggrieved party in a substantially better position than full performance would have done. [**Reinstated by Drafting Committee, 9/96.**] 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.

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. The underlined language in subsection (c) is designed to implement an exception for agreed remedies as stated above.

5. As requested by the Drafting Committee at the Jan. 1997 meeting, the following is a draft comment that relates this section to the other remedies sections and explains how the principles should be applied. Does the comment reflect what the committee intends?

Proposed Comment to 2-803

1. The purpose of this section is to set forth the remedial policies of this Article in order to guide the court's application of the specific remedies found in Subparts B and C of Part 8. When a contract is breached, the goal in application of the remedial provisions is to provide the aggrieved party the benefit of the bargain, that is, to place the aggrieved party in as good a position as if the breaching party had performed the contract. Subsection (a) states that general principle.

2. When a contract is breached, the aggrieved party is deprived of the breaching party's promised performance. If the seller fails to provide goods that conform to the contract, the buyer is harmed by not receiving the value of the conforming goods. If the buyer breaches, the seller is deprived of the value that seller was to receive in exchange for the goods. One way of starting to put an aggrieved party in such a position is to award the very performance promised. Thus the seller as aggrieved party could seek the price under §2-822 or specific performance under §2-807. Likewise, the buyer could seek specific performance under § 2-807 or have a specific right to obtain the goods from the seller under §2-807(c) or §2-824. Specific performance is traditionally an equitable remedy and may not be available in a particular case or the aggrieved party may not seek specific performance. Similarly, an aggrieved seller may not be entitled to the price or the aggrieved buyer may not be entitled to get the goods. In those circumstances, the diminution in value to the aggrieved party must be measured.

3. General damages can be measured in several ways as provided in Subparts B and C.

If the seller breaches the contract, the buyer's general damages can be measured in one of three ways. If the buyer has accepted goods, and not revoked acceptance, the buyer is entitled to the difference in value between the value of the goods accepted and the value

the goods would have had if the goods had conformed to the contract. §2-827. If the buyer has not accepted the goods or revoked acceptance as to the goods, the buyer has two choices as to the measurement of general damages. First, the buyer can cover, obtain substitute goods for those not provided, and recover the difference in value between the cover cost and the contract price. § 2-825. Second, if the buyer does not cover the buyer's general damages for seller's breach of contract will be measured by the difference between the contract price and the market price for the goods. § 2-826.

If the buyer breaches the contract, the seller's general damages can be measured in several ways. The seller could resell the goods under § 2-819 and recover the difference between resell price and contract price. The seller could, alternatively, recover the difference between the market price and the contract price. § 2-821(a). Finally, the seller could seek to recover the seller's lost profit and expenditures in reliance on the contract with the buyer. §2-821(b).

All of these general damage measurements are designed to compensate the aggrieved party for the lost value of the breaching party's promised performance. If for some reason, these general damage reasons do not suffice to place the aggrieved party in that position, then § 2-804 can be used as a general damage measurement.

4. In addition to that lost value of the promised performance, many times the aggrieved party suffers losses as a consequence of failing to receive the breaching party's performance. Compensating these consequential losses is part of placing the aggrieved party in the position it would have occupied but for the breach of contract. This recovery for consequential damages is in addition to the recovery for general damages. Traditionally the recovery of consequential damages were scrutinized to make sure that the breach in fact caused the consequential harm, the damages were reasonably certain in amount, the damages were not reasonably subject to mitigation by the aggrieved party, and the harm was a risk that was allocated to the breaching party as a foreseeable consequence of the breach. Article 2 continues that traditional view of consequential damage recovery in §2-806.

5. Finally, in addition to making the aggrieved party whole through recovery of general damages and consequential damages, the aggrieved party may have incurred incidental expenses in dealing with the goods after breach that do not easily fall into either of the other two categories. § 2-805. An aggrieved party's recovery of these amounts rounds out the aggrieved party's recovery of the full performance position.

6. The Subsection (a) principle is subject to § 1-106 in order to make clear that punitive remedies are not generally provided for in breach of contract cases under this Article. One example of a penalty that is authorized under Article 2 for breach of contract is § 2-809(b).

7. In many contracts, the parties will have altered the default remedies set out in this Article. One example is a liquidated damages clause, enforceable under § 2-809. Another example is a limited remedy enforceable under §2-810 or an exclusion of liability for consequential or incidental damages enforceable under §2-810(c). If such a contract clause is part of a contract under §2-206 and §2-207 and is enforceable under §2-809 and §2-810, the principle of this section does not

override those contractual agreements regarding the allocating of risk of breach.

8. The ability of the aggrieved party to choose any of these various general damage remedies is limited by the general principle that a party cannot recover more than once for the same loss. Subs. (c). For example if an aggrieved buyer covers, under § 2-825, the aggrieved buyer cannot get both cover price - contract price differential and market price- contract price differential. Similarly an aggrieved seller who resells under §2-819 may not get both the resell price - contract price differential and the market price - contract price differential.

9. Subsection (b) provides that an aggrieved party cannot recover for losses that could have been reasonably mitigated. Although the mitigation principle is most often associated with reduction of consequential damages, see § 2-806, there may be instances where the general damages of the aggrieved party should have been mitigated. Under §2-821 and §2-826, the aggrieved party can seek to measure their general damages by the difference between the contract price and the market price at the time of performance. If the breaching party can show that the aggrieved party could have realistically mitigated its general damages by reselling or covering as the case may be, then the aggrieved party's general damages should be reduced accordingly. Similarly, if the breaching seller can demonstrate that a cure that is not sufficient to cure the breach under §2-709 would have minimized the aggrieved buyer's general damages, the breaching seller can seek to have the buyer's general damages reduced accordingly. An aggrieved seller who is exercising rights under §2-817 may take that action to mitigate the harm from the buyer's breach but may not take that action if it is designed to increase the amount of damages due to the buyer's breach.

10. Finally, subsection (c) also provides a controlling principle on remedial choice: A court may deny or limit a remedy if it provides an aggrieved party substantially more than its full performance position. How should this principle operate in practice?

(a) This principle should not be used to limit or deny the aggrieved party's cover or resale remedy. Thus if the aggrieved buyer covers under § 2-825 and seeks the cover price-contract price difference or the aggrieved seller resells under § 2-819 and seeks the resell price - contract price difference, the market price - contract price differential is not relevant to determine if the seller or buyer are over compensated. The requirements for cover and resale contain enough protections against overcompensation and no additional protection is afforded the aggrieved party by this principle. Assume an aggrieved buyer who covers at \$20 per unit when the contract price is \$15 per unit. The cover complies with all of the requirements of §2-825. Even if the market price is \$18 per unit so that the market price measure would yield general damages of \$3 per unit, the buyer is entitled to recover \$5 per unit and is not overcompensated. Similarly, assume the aggrieved seller resells under §2-819, complying with all of its requirements, for \$15 per unit when the contract price is \$20 per unit. The aggrieved seller is entitled to recover the \$5 per unit even if the market price per unit is \$18 so that the market price measure would yield \$2 per unit. The aggrieved seller is not overcompensated by its recovery of the \$5 per unit.

(b) Assume, however, that the buyer covers as provided in § 2-825 or the seller resells as provided in §2-819 and then seeks the market price - contract price difference as it provides for more damages than the cover price - contract

price differential or the resell price-contract price differential. Continuing the example above, the aggrieved buyer covers at \$20 per unit when the contract price is \$15 per unit. The market price at the relevant time for measuring market however is \$25 per unit. The buyer is overcompensated if it attempts to collect the \$10 per unit under §2-826 instead of the cover price-contract price differential of \$5 per unit under §2-825. If the aggrieved seller resells under §2-819 at \$15 per unit when the contract price is \$20 per unit, and the market price at the relevant time for measuring market is \$10 per unit, the aggrieved seller is overcompensated if it attempts to recover the \$10 per unit market price-contract price differential under §2-821 instead of the \$5 per unit resale price-contract price differential under §2-819. To cover or resell in accord with those sections means that all of the requirements of those sections are fulfilled. Thus if the buyer's purchase was not to substitute for those goods from seller, a cover has not really taken place. If the seller's resell was not defined as referring to the breaching contract then a resell under that section has not taken place.

[c] If the reselling seller complies with §2-819 and the resell price-contract price differential is less than the lost profit and reliance measure under §2-821(b), this principle could be used to confine the reselling seller to the lower measurement of general damages. If the reselling seller wants to recover the lost profit measure under §2-821(b), the seller should not identify the resale as pertaining to the breached contract under §2-819(b)(3).

This principle does not allow an argument that a seller who who has not resold and seeks lost profit and reliance damages that would be more than the market price contract differential is being overcompensated. In the situations where seller seeks to prove lost profit, in all likelihood, the market price contract differential is undercompensatory.

However, this principle does prevent the seller from choosing the market price-contract price difference when it is more than the seller's lost profit and reliance damages.

(d) The principle of not overcompensating the aggrieved party could be used to control the buyer's ability to contend that a repair of an accepted good in the proper measurement of the loss in value because of the good's nonconformity if that amount is substantially more than the difference between the the market value of the good as warranted and the value of the good accepted.

(e) Finally, the concept of not overcompensating the aggrieved party could be used to police the aggrieved party's use of non-expectancy measures of harm, such as the reliance or the restitution interest. See comment following §2-804.

11. Because measurement of damages is not an exact science, the court should not be concerned with minor differences between the different measurements of general damages. For example, assume the aggrieved seller who has not resold proves that the market price - contract price differential is \$100 per unit. The buyer submits proof that the seller's lost profit and reliance damages range from \$90-105 per unit. In that situation, the seller who is awarded the market price measure of \$100 per unit may be overcompensated if the buyer's proof of lower end of the lost profit range is correct and undercompensated if the higher end of the range is accurate. The seller's choice of the market price measure does not substantially overcompensate the seller.

In sum, part 8 does not favor the market damages when the seller properly resells or the buyer properly covers. These substitutional remedies are preferred, because they best approximate the position the plaintiff would be in upon full performance. Market price, at best, is a surrogate for resale or cover. Thus, in these cases, neither plaintiff nor defendant can insist on the market damages. Similarly, if there has been no qualifying resale or cover and the aggrieved party chooses a lost profits remedy, i.e., a remedy that measures lost profits without regard to market price, the defendant cannot object. Market price is, at best, an imprecise, artificial way of measuring the value of a particular transaction and will undercompensate in most cases. Finally, if there is no qualifying resale or cover and the plaintiff chooses the market price remedy, the defendant may be able to show that market damages exceed the lost profits that would have been made upon full performance. In these cases, a court may be persuaded to require the plaintiff to use the lost profits remedy.

SECTION 2-804. MEASUREMENT OF DAMAGES IN GENERAL. To the extent that a breach of contract does not substantially impair the value of the installment or the whole contract is not material under section 2-710 or 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:

- (1) recover compensation for 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; and
- (2) exercise any rights or remedies provided in the agreement.

SOURCE: Sales, Section 2-714(a); Licenses, Section 2B-702.

Notes

1. This section, which is derived from §2-801 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. Those other interests of the aggrieved party might be the reliance interest, where the aggrieved party would be if the contract had not been entered into, or the restitution interest, restoration of the unjust gains of the defendant to the plaintiff. Thus, the buyer might recover reliance damages as an alternative if expectation cannot be proved with reasonable certainty.

To illustrate, suppose the seller agrees to manufacture goods to meet the buyer's particular purposes. The seller repudiates and goes into bankruptcy. Section 2-804 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 §§2-805 and 2-806. Direct

damages typically protect the plaintiff's investment in and expectation from receiving the bargained for performance. Consequential damages typically protect the plaintiff's investment in and expectation from using the promised performance.

3. An issue that the drafting committee should address is whether there should be a limitation on reliance based damages or restitution based damages when those damages exceed the expectancy. One situation where those damages may exceed the expectancy is noted above, when the expectancy is too speculative or cannot be proven. The principle in §2-803(c) should not prevent the aggrieved party from obtaining a restitution or reliance recovery.

Another situation where those damages may exceed the expectancy measure is when the contract is a losing contract. That is, expectancy is a negative number. The reliance or restitution measurement will provide a higher measurement. Should the code allow a person to be better off if the other person breaches than if the person performs the contract? This could lead to the person with a negative expectancy into "goading the other party into breaching in order to recover reliance or restitution damages. To illustrate, assume seller and buyer enter into an installment contract for 10 deliveries at \$20,000 per delivery. Seller's cost of performing is actually \$25,000 per delivery and the market price at time of delivery is \$20,000 and Seller could resell undelivered goods for at most \$20,000. Thus on each delivery that Buyer accepts, Seller is losing \$5,000. Seller's general damage recovery under either market or resell formula is \$0. Buyer breaches. Under a restitution theory, the seller could argue that it should get the value of the benefit it conferred on Buyer. If the value of the benefit conferred on buyer is measured by the market value of the goods, the restitution recovery is identical to the expectancy recovery. If the value of the benefit conferred on the buyer is measured by the contract price the buyer agreed to pay, than as to any installments accepted, the buyer is already liable for the price under §2-822, and the seller gets no benefit from asserting restitution. If the value of the benefit conferred on buyer is measured by the cost of performance, then the seller will get the \$25,000 per delivery as to the goods accepted by the buyer. See Boomer v. Muir, 24 P.2d 570 (Cal. App. 1933) (a construction contract situation where the value of the benefit conferred on the buyer was measured by the cost of performance of the builder); U.S. v. Western States Mechanical Contractors, 834 F.2d, 1533 (10th Cir. 1987) (subcontractor's contract price was \$295,706, the reasonable value of work under the subcontract as determined at trial was \$475,000, subcontractor wrongly fired so general contractor in breach, 40% of the work was done by subcontractor prior to firing, subcontractor received 40% of \$475,000 as restitution for the value of the work performed). See also Restatement (Second) Contracts §371. One could read the principle of §2-803(c) from preventing restitution or reliance when the party enters into a losing contract. If the party completely performs the contract and they are owed only money, the Restatement (Second) Contracts §373(2) provides that restitution is not allowed, thus the seller would be limited to the price.

SECTION 2-805. INCIDENTAL DAMAGES. Incidental damages resulting from breach of contract include compensation or any commercially reasonable charges, expenses, or commissions incurred with respect to:

- (1) inspection, receipt, transportation, care, and custody of the goods after the other party's breach;
- (2) stopping delivery or shipment;

- (3) effecting cover, return, or resale of the goods; ~~and~~
- (4) reasonable efforts otherwise to minimize or avoid the consequences of breach; and
- (5) otherwise dealing with the goods or effectuating other remedies.

SOURCE: Sales, Sections 2-715(1), 2-710.

Notes

1. Section 2-805 combines the incidental damages of seller and buyer into a single section. It replaces §§2-710 and 2-715(1) of the 1990 Official Text.

2. Incidental damages are reasonable expenses incurred in anticipation of or 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 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. Subsection (5) was added to provide more of a catchall category.

SECTION 2-806. CONSEQUENTIAL DAMAGES. Consequential damages to a seller, buyer, or other person under this article are compensation for losses, ~~including injury to person or property~~, resulting from a breach of contract which:

(1) the party in breach at the time of contracting had reason to know would probably result from the aggrieved party's general or particular requirements and needs;

(2) could not have been avoided ~~by the aggrieved party or the party in breach~~ by reasonable measures under the circumstances; and

(3) except for injury to the person, the aggrieved are not unreasonably disproportionate to the risk assumed by the party in breach under the contract. The burden to establish that the loss is unreasonably disproportionate is on the party in breach.

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 §2-806, have been made. **The November, 1996 further clarifies and integrates the section in light of continuing discussions. The main**

change is that injury to “person or property” is now subject to the general limitations on any consequential damage rather than the requirement, previously in paragraph (2), that they be “proximately” caused by a breach of warranty.

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 §2-810, in combination with §1-106(1), denied consequential damages to sellers.

The following examples illustrate the application of §2-806 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 the Buyer had reason to know at the time of contracting of the aggrieved party's particular financing arrangement. 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." §2-806(b) (January, 1996).

After discussion at the November 1996 meeting, two additional changes were made. First, the unreasonably disproportionate limitation does not apply to consequential losses which are personal injury damages. Second, the unreasonably disproportionate limitation is something that the breaching party must establish as part of an “affirmative defense” to the consequential

damage case of the aggrieved party rather than requiring the aggrieved party to establish in every case that the consequential losses were not unreasonably disproportionate.

At the January 1997 meeting, an issue was raised whether damage to other property should also be exempted from the unreasonably disproportionate test. No action was taken on this suggestion.

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 2-806 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:

(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, 2-806 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 §2-803(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 §2-803(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). An unresolved issue is whether the plaintiff must bear the burden of proof that it mitigated its consequential damages as part of its case to recover consequential damages or whether mitigation is in the nature of an affirmative defense that the defendant must establish that the plaintiff failed to mitigate in order to reduce the amount of consequential damages. Section §2-803(b) and normal rules of plaintiff's burden present this issue.

(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 §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.

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 2-807. SPECIFIC PERFORMANCE.

(a) A court may enter a decree for specific performance if the parties have expressly agreed to that remedy or the goods or the agreed performance of the party in breach are unique or in other proper circumstances. However, if specific performance is expressly agreed to, a decree for the contract price may not be entered unless the conditions of Section 2-822 are also satisfied.

(b) A decree for specific performance may contain terms and conditions as to payment of the price or damages or other relief the court considers just.

(c) A buyer may recover from the seller 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 §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 §2-822. 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 §2-822.

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 §2-822(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. **The last sentence in subsection (a) was agreed to by the Drafting Committee at the September, 1996 meeting.**

2. Subsection (c) has only one change from former §2-716(3), the word "replevin has been changed to "recover. By stating replevin, the former §2-716(3) made clear that the buyer had a legal, not equitable, process to obtain possession of the goods in that circumstance. With the word "replevin changed to recover, it may no longer be clear that this right is any more than a particularization of a circumstance where the equitable remedy in subsection (a) might be appropriate. Is that what the drafting committee intends? In addition, since this subsection is a buyer's remedy that is supposedly not an equitable specific performance remedy, should this subsection be moved to the subpart on buyer's remedies? This section and §2-824 now overlap

to a considerable extent. See notes following §2-824.

3. CISG. Specific performance is the preferred remedy for sellers and buyers under the . See Articles 46 and 62. See also, Steven Walt, For Specific Performance Under the United Nations Sales, 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 ."

SECTION 2-808. CANCELLATION: EFFECT.

(a) Except as otherwise provided in Section 2-702 and 2-709, an aggrieved party may cancel a contract if there is a breach under Section 2-701, or in the case of an installment contract, a breach of the whole contract under Section 2-710(c), or if agreement so provides.

(b) Cancellation is not effective until the canceling party notifies ~~sends notice of cancellation to~~ the other party.

(c) Except as otherwise provided in subsection (e), upon cancellation, all obligations that are still executory on both sides are discharged.

(d) The ~~following~~ obligations surviving ~~survive~~ cancellation include:

(1) a right based on previous breach;

(2) any right, remedy, or obligation that the contract provides as surviving cancellation; ~~a limitation on the scope, manner, method, or location of the exercise of rights in goods;~~

(3) a limitation on disclosure of information;

(4) any provision concerning resolution of disputes under the contract ~~an obligation to return goods, if one exists, which obligation must be promptly performed;~~ and

(5) a remedy for breach of the whole contract or any unperformed balance.

(e) Unless a contrary intention clearly appears, language of cancellation, rescission, or avoidance of the contract or similar language is not a renunciation or discharge of any claim in damages for an antecedent breach of contract.

SOURCE: Sales, Sections 2-106(3)(4); Licenses, Section 2B-704.

Notes

1. This section is derived from former §2-106(4). Under that section, cancellation was defined as putting an end to the contract because of a breach by the other party. Section 2-102(a)(4) continues that definition of cancellation. An aggrieved party's right to cancel was implied in former §2-612(3) upon breach of the whole contract in an installment contract and provided for explicitly in the index of seller's remedies, former §2-703(f), and in the index of buyer's remedies, former §2-711(1). Cancellation as an aggrieved party's remedy for breach is contained in §2-710(c), §2-815, §2-823. Under former §2-720, a cancellation was not construed as a rescission of the contract unless such intent of the canceling party was clear. See §2-808(e). As provided in former §2-106(4), the effect of a cancellation was to discharge obligations which are executory on both sides while the canceling party retained its remedies for breach based upon prior performance and any remedies for breach of the whole contract and future performance. See §2-808(c) and (d). Thus the effect of an aggrieved party's cancellation was that neither the aggrieved party or the breaching party had to render future performance but the aggrieved party retained all remedies for breach against the breaching party as to both the past and future performance of the breaching party.

2. Because cancellation is not rescission of the contract, the performance already rendered need not be returned to the other party. For example, if seller is the breaching party and has delivered a non-conforming installment of goods and the nonconforming installment results in a breach of the whole contract, the buyer may cancel the contract. When the buyer cancels, the buyer need not return the non-conforming installments to the seller, but has the right to obtain damages due to the non-conformity of those past installments. The cancellation means that the seller need not deliver any of the remaining installments but the seller is liable for breach of the whole contract. If the parties have already rendered their performance so that obligations are not executory on both sides, then cancellation is a meaningless remedy. Assume in a one shot contract that the seller has delivered non-conforming goods and the buyer has accepted those goods. The buyer cancels due to the non-conformity. The buyer is still liable for the price and has a counterclaim for damages under §2-827 unless buyer can revoke acceptance under §2-707. The buyer's cancellation does not affect the buyer's obligation to pay for the goods nor give the buyer the ability to return the goods to the seller outside of the revocation right.

3. The section retains all of the above points and adds the following. First, the aggrieved party cannot cancel if they have waived the breach under §2-702 but the aggrieved party may pursue other remedies for breach. Second, the cross reference to §2-709 should make clear that an aggrieved party cannot cancel if the breaching party has the ability to cure the breach under that section. Third, subsection (b) provides that cancellation is effective when the aggrieved party notifies the other party. See §1-201(26). Fourth, subsection (d) contains a **non-exclusive** list of what rights remain effective upon cancellation. Subsections (1) and (5) continue current law, see former §2-106(4). Subsection (2) is designed to allow the parties to provide in their contract the obligations that should survive cancellation. Subsection (3) recognizes the validity of non-disclosure agreements after cancellation of the contract for sale. Subsection (4) allows enforcement of alternative dispute resolution clauses, choice of forum clauses, choice of law clauses, clauses regarding reduction of the statute of limitations period as allowed under §2-814 as well as any other provision regarding dispute resolution that is enforceable under other law. Cancellation of the contract should not affect those rights.

4. **CISG.** CISG's equivalent to "cancellation" is "avoidance" for a fundamental breach of contract. See Art. 25, 49(1) and 64(1). The effects of a proper avoidance are stated in Art. 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. Art. 75 and 76.

SECTION 2-809. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages for breach of contract may be liquidated but only in an amount that is reasonable in the light of either the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach. If a term liquidating damages 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:

(1) the amount to which the seller is entitled under a term liquidating damages in accordance with subsection (a); or

(2) in the absence of such terms, 20 percent of the value of the total performance for which the buyer is obligated under the contract or \$500[\$1,000], whichever is less.

(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. See Licenses, Section 2B-706.

Notes

1. Subsection (a) preserves former Section 2-718(1) with the following exceptions: The liquidation need only be reasonable in light of either the actual or then anticipated loss (ex ante breach) and the difficulties in proof of loss, not also in light of the difficulties in obtaining a remedy. After the September, 1996 meeting, a sentence in the July, 1996 Draft stating that a term liquidating damages in an unreasonably large or small amount is unenforceable was deleted. At the January, 1996 meeting, the Drafting Committee had voted to delete a special rule for consumer contracts and to approve subsection (a) in the July, 1996 Draft. A suggestion that a

court should have power to fix damages if the liquidation clause was unenforceable was not acted on.

3. Section 2-809 (2-710 in the July, 1996 Draft) deals with the liquidation of damages not the limitation of damages by agreement. The limitation agreements are covered by §2-810. 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 under liquidated. There is no need to ask whether enforcement of the under liquidated damage clause is unconscionable. 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 §2-810(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. The breaching buyer's right to restitution under subsection (b)(2) is subject to a penalty offset if there is no liquidated damages term. The PEB study committee recommended that this provision be eliminated. Previous drafts had eliminated this mandatory offset. Does this mandatory offset make sense? If the mandatory offset is preserved, then should the amount be raised?

5. **CISG:** There is no provision dealing with liquidated damages. Restitution claims are permitted in certain cases of avoidance for fundamental breach. See Articles 81(2), 82 and 84.

SECTION 2-810. CONTRACTUAL MODIFICATION OF REMEDY.

(a) Subject to Section 2-809, the following rules apply:

(1) An agreement may add to, limit, or substitute for the remedies provided in this article, such as by, limiting or altering the measure of damages recoverable for breach of contract or limiting 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[,such as restitution for any benefits conferred on the party in breach].

(3) Resort to an agreed remedy under paragraph (1) is optional. However, if the parties expressly agree that the agreed 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:

~~Alternative A~~

(1) In a contract other than a consumer contract, the aggrieved party, to the extent of the failure, may resort to remedies provided in this article but is bound by any other agreed remedy that is not dependent upon the failed remedy.

Alternative B

(1) In a contract other than a consumer contract, the aggrieved party may resort to all remedies provided in this article, but an agreement expressly providing that incidental or consequential damages, including those resulting from the failure to provide the limited remedy, are excluded is enforceable to the extent permitted under subsection (c).

~~{END OF ALTERNATIVES}~~

(2) In a consumer contract, an aggrieved party may reject the goods or revoke acceptance and, to the extent of the failure, ~~has other remedies under Section 2-823~~ may resort to all remedies provided in this article despite the terms of the agreement.

(c) Subject to subsection (b), consequential damages ~~including compensation for injury to property, but not for injury to a person,~~ and incidental damages may be limited or excluded by agreement unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods [consumer contract] is prima facia unconscionable.

SOURCE: Sales, Section 2-719; Licenses, Section 2b-706.

Notes

1. Section 2-810(a) validates agreements modifying or limiting remedies. The unstated assumption is that such agreements must be conscionable at the time of contracting, §2-105, and not otherwise subject to the defenses of fraud, mistake or duress. See §1-103. Due to the deletion of §2-602 on service contracts, Article 2 does not provide a standard of performance for service promises. The classic service promise is the seller promising to repair or replace nonconforming goods. The issue is what level of performance is required. If the seller has a right to cure, the cure provision specifies that the cure must result in conforming goods. §2-709. A repair or replacement promise as an exclusive agreed remedy for breach of a warranty of quality should also result in conforming goods. This point could be made in the comments to this section. If the repair or replacement promise is breached and repair or replacement is the exclusive agreed remedy, that situation should be treated as a failure of the essential purpose of the agreed remedy

under subsection (b).

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). This suggested limitation has been added to subsection (a)(2). Once concern with adding the bracketed restitution language to subsection (a)(2) is that a very traditional agreed remedy is the repair or replace remedy. That is not a restitutionary remedy but in many circumstances a quite adequate remedy. In a particular case, it may be less than restitution of benefit conferred on the breaching party, depending upon how that benefit conferred is measured. Will the bracketed phrase throw doubt on the adequacy of those traditional agreed remedies? To test whether the contract provides a minimum adequate remedy, the comparison could be to the expectancy interest, to the restitution interest, or to the reliance interest of the aggrieved party. It could also be tested by deciding whether the contract was illusory because the breaching party in effect limited the remedy so that the aggrieved party had no effective recourse for the breach of contract.

After discussion at the January and March, 1996 meetings, the Drafting Committee approved the language in §2-810(a)(2) as a limitation on the agreed remedies permitted in §2-810(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 §§2-103(a)(3), 2-804. 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), Alternative A, 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 §2-810(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. The underlined language in subsection (b) makes that clear. 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.

At the September, 1996 meeting of the Drafting Committee, Alternative B was proposed by the ABA/UCC Subcommittee and ~~is~~ was included for consideration at the ~~next meeting~~ November meeting. At the November 1996 meeting the drafting committee voted in favor of Alternative B. Accordingly Alternative A has been deleted. Under Alternative B, when a limited agreed remedy fails, the consequential damage excluder is still effective if enforceable under subsection (c). Thus an aggrieved party would get the remedy that substitutes for the failed remedy but would not get consequential damages if the contract excludes them. Also at the November meeting, the committee discussed whether a clause excluding incidental damages should be enforced after an agreed remedy has failed. The underlined phrase in subsection (b)(1) is included for discussion and decision.

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). At the November 1996 meeting, the drafting committee voted for the opposite presumption in consumer contracts as in commercial contracts. That is, in consumer contracts, the consequential and

incidental damages excluder clauses would **not** be enforceable in the situation where the agreed remedy failed. The consumer advocates expressed some concern that the draft did not clearly express that choice. The underlined language in subsection (b)(2) is intended to make that policy choice clear.

3. Subsection (c), which is subject to subsection (a)(2), provides that except for injury to person, ~~see [§2-411]~~, 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. 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 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 (d) 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." At the November 1996 meeting the drafting committee voted to restore the principle from the last sentence of former §2-719(3). The underlined language in subsection (c) is taken from former §2-719(3). The committee should decide whether to apply that principle to "consumer goods" or "consumer contracts. The draft as it now stands provides in subsection (c) the same rule as provided in former §2-719(3) except that incidental damages can be excluded as well.

5. CISG: There is no comparable provision in the . Is §2-810 a rule of validity within Article 4(a)? If so, should Article 2 say so?

SECTION 2-811. REMEDIES FOR MISREPRESENTATION OR FRAUD.

Remedies for material misrepresentation or fraud include all remedies available under this article for nonfraudulent breach of contract. 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 consistent remedy.

SOURCE: Sales, Section 2-721.

Notes

There are no revisions of substance to former §2-721.

SECTION 2-812. PROOF OF MARKET PRICE.

(a) If evidence of a price prevailing at a time or place 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 proper allowance for any 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.

Notes

1. Section 2-812 is an integration of former §§2-723 and 2-724, with one exception. Former §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 §§2-721 and 2-727 in the March, 1995 Draft. At the March, 1995 Meeting, the Drafting Committee rejected the theory underlying §§2-721 and 2-727 and directed a redraft. See §§ 2-821, 2-826 regarding measuring damages when the case comes to trial before the time set for performance.

2. Historical Note: The reasons for the proposed and now rejected revision are as follows. Original §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 §2-723(1), however, created several dilemmas:

First, it appeared to be inconsistent with the provision for repudiation damages in §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 §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 §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 §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.

3. CISG. Article 76 states the time when and place where the current price for damages is to be determined, but makes no provision for proof of market price.

SECTION 2-813. 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 the 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 that had the risk of loss under the contract for sale, or since the injury has assumed that risk as against the other party, 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.

Notes

There are no changes of substance in former §2-722 of the 1990 Official Text. This

provision is merely a procedural rule that details who has standing to pursue the damages for harm to the goods. The injury to the goods is generally actionable under law other than Article 2.

SECTION 2-814. STATUTE OF LIMITATIONS.

(a) An action for breach of a contract under this article must be commenced within four years after the right of action has accrued. The parties to the original agreement may not extend the four-year period of limitation. Except in a consumer contract or an action for indemnity, the parties to the original agreement may reduce the period of limitation to not less than one year. ~~but the four year period of limitation not be extended.~~

(b) Except as otherwise provided in subsection (c), and Sections 2-402(e) and 2-404(e), a right of action for breach of contract accrues when the breach of contract occurs, even if the aggrieved party did not have 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 for breach of warranty accrues when the seller has tendered delivery of [, or has completed any agreement to assemble or install,] ~~nonconforming~~ the goods, whichever is later.

(2) If a warranty expressly extends to performance of the goods after delivery, a right of action accrues when the buyer discovers or should have discovered the breach.

(d) A right of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or, if earlier, should have been discovered by the indemnified party, [whichever is later.]

(e) If an action commenced within the applicable time limitation is terminated but a remedy by another action for the same breach of contract 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.

(f) 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.

Notes

1. Subsection (a) retains the time of breach rather than the time of discovery rule for all but certain breach of warranty claims. See subsection (c)(2). Thus, an action must commence within four years of the breach, unless commercial 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 different 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. Agreements to extend the limitation are unenforceable. The changes to that subsection are to clarify that result.

At the January, 1996 meeting of the Drafting Committee, the Reporter was asked to include indemnity claims in 2-824. The language in subsection (d) is based upon 2A-506. The language "whichever is later" is bracketed. Even though taken from §2A-506, does it make sense that a party would be able to argue that the later (should have been discovered time) is the time the cause of action accrued if the party actually discovered the act or omission earlier, say by not following normal procedures, even though if followed normal procedures the party would not have (should have) discovered the act or omission until later? To clarify when the cause of action accrues in this situation, the underlined words "or, if earlier" have been added and the bracketed words should be deleted.

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 §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. This issue was raised at the December, 1996 meeting of the ALI Council and the Council, by a vote of 20-11 expressed a preference for a "discovery" rule where building materials and similar products were involved.

At the January, 1996 meeting the Drafting Committee adopted Alternative A in principle. Several issues raised at that meeting have been resolved in the November, 1996 Draft. The bracketed words in subsection (c)(1) are to raise the issue of whether that timing is appropriate given the decision to not include seller service contracts within article 2. Subsection (c)(2) leaves the "warranty extend to future performance" test as under current law. Under current law, courts treat these two promises differently for statute of limitations purposes. Promise 1 is a promise that the goods will be free of defects for a period of time and that the seller will repair or replace the goods if a defect arises during that time. Promise 2 is a warranty of quality coupled with a promise to repair or replace the goods for one year if the warranty is breached. Courts

treat Promise 1 as a warranty explicitly extending to future performance and the discovery accrual rule applies. Courts treat promise 2 as not a warranty that explicitly extends to future performance, rather the goods must conform at time of tender and the promise to repair is good for a year. The cause of action for breach of warranty accrues upon tender of delivery, and the cause of action for failure to repair would accrue upon the seller's failure to do so. Is this a distinction the code should continue to foster?

3. **CISG.** The CISG has no statute of limitations. Parties must rely upon the on the Limitation Period of the International Sale of Goods (1974), which the United States has now ratified.

[B. SELLER'S REMEDIES]

SECTION 2-815. SELLER'S REMEDIES IN GENERAL.

(a) If a buyer is in breach of contract, the aggrieved seller, with respect to any goods directly affected and, if the breach is a breach of the whole contract, with respect to an undelivered balance, may:

(1) withhold delivery of the goods;

(2) stop delivery of the goods by any carrier or bailee pursuant to Section 2-818(b);

(3) proceed under Section 2-817 with respect to goods still unidentified to the contract;

(4) reclaim the goods under Section 2-816(a)(2) when payment is not made;

~~(4)~~ (5) obtain specific performance under Section 2-807 or recover the price under Section 2-822;

~~(5)~~ (6) resell and recover damages under Section 2-819;

~~(6)~~ (7) recover damages for repudiation or nonacceptance under Section 2-821;

~~(7)~~ (8) recover incidental and consequential damages under Sections 2-805 and 2-806; or

~~(8)~~ (9) cancel the contract under Section 2-808.

(b) If the buyer is insolvent, the seller may reclaim goods under Section 2-816(a)(1) or stop delivery under Section 2-818.

SOURCE: Sales, Section 2-703.

Notes

1. Subject to the general policies in Part 8, subpart A, this section states the seller's remedial options that are triggered by the breaches defined in §§2-701 and 2-710. Although not all remedies are available in every case, they are stated cumulatively. Remedial choices are limited by all of the provisions of Subpart A, including §2-803(c), §2-801. Thus any limited exclusive agreed remedy or liquidated damage clause if enforceable under §2-809 and §2-810 would make some or all of these remedies unavailable to the aggrieved seller. Because Subpart A's provisions state that the remedies in Subpart B are subject to the conditions of Subpart A, it is unnecessary to state any further limitations on remedies here. The enforceable provisions of the agreement and this article already limit the seller's remedy choice without restating that principle here. See the proposed comment to §2-803 regarding what remedial choices should be policed. Subsection (b) collects the two remedies based upon the buyer's insolvency and not the buyer's breach.

Breach by wrongful rejection or wrongful revocation of acceptance are, in fact, breaches by non-acceptance. See §2-821. 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 §2-822 or reclamation under § 2-816(a)(2).

Whether the seller can resort to remedies under this section for repudiation, depends initially upon §2-712: The seller may not resort to §2-815 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 who is in breach.

What about purchasers from or creditors of the breaching 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 §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. A different answer may be required where the seller is in breach and the buyer has the right to obtain possession as against the seller under the buyer's remedy sections even though the buyer does not yet have physical possession of the goods.

These remedies are supplemented by the power to suspend performance after a demand for adequate assurance, §2-711 or where the buyer is insolvent. §2-818(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, §2-807, an action for the

price, §2-822, damages based upon the difference between the contract and market price, §2-821(a), and damages measured by lost profits, 2-821(b). Claims for incidental damages are made under §2-805 and claims for consequential damages, to which the seller is now entitled, are made under §§2-805 and 2-806.

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 2-816. 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 that 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 90 days 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, the 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 precludes all other remedies with respect to them.

SOURCE: Sales, Sections 2-507(2), 2-702.

Notes

1. Revised 2-816 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 §9-503. See also, §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. Should the 10 day time period be expanded? Under 11 U.S.C. §546(c), if the buyer files bankruptcy during the 10 day period, the seller gets 20 days to give its reclamation notice. Should misrepresentations of solvency to persons other than the seller but upon which the seller relied (credit reports) be allowed to expand the time for reclamation? 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 §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 (a)(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 §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. **This decision was questioned at the 1996 Annual Meeting of NCCUSL and should be coordinated with Article 9.**

The provision in the 1990 Official Text of §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.

In that discussion, it is helpful to distinguish between reclamations under subsection (a)(1) and reclamations under subsection (a)(2). Reclamations under subsection (a)(1) do not involve a breach of contract by the buyer. Reclamations under subsection (a)(1) are based upon a special remedy triggered solely by the buyer's insolvency not the buyer's breach. Reclamation for insolvency is based upon a presumed fraud that the buyer is perpetrating on the seller. In that situation, when a seller reclaims, in effect the seller is rescinding the contract as a remedy for that fraud. In a rescission, both sides return the performance of the other. With that justification for insolvency based reclamations, it makes sense to limit the seller to only its reclamation right and not give it other remedies against the buyer.

Reclamations under subsection (a)(2) do involve a breach of contract by the buyer. Thus it may be inappropriate in a reclamation under subsection (a)(2) to limit the seller to reclaiming the goods and not having any further remedies. Compare what happens if the buyer refuses to pay prior to delivery. The seller has the goods and all remedies under the code, including the right to damages measured either by resale or contract price. If the seller delivers and the buyer

does not pay because of a bounced check, the buyer has breached the contract and the seller has the right to reclaim the goods. It is not at all clear that the seller should be limited to getting the goods back and not getting any further damages for the breach of contract.

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 purchasers 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 purchasers 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, at the earliest, 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 §2-816 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 §2-816 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 §2-702(1) of the 1990 Official Text now appears in revised §2-818(a).

7. **CISG.** Under the , 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 Art. 64(1), 81(2), and 84(2).

**SECTION 2-817. SELLER'S RIGHT TO IDENTIFY GOODS TO CONTRACT
DESPITE 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 of contract; 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 of contract, 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.

Notes

1. No changes of substance have been made in former §2-704 of the 1990 Official Text.
2. Section 2-817 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, §2-502, and pursue appropriate remedies. Subsection (a)(2) permits the seller to resell identified but unfinished goods, a remedy that already exists under §2-819(b). Neither option explicitly requires the exercise of "reasonable commercial judgment" but both are subject to the general mitigation requirement in §2-803.

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 §2-821(b) would be \$400. All things being equal, §2-817(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 does not have a comparable provision.

SECTION 2-818. SELLER'S REFUSAL TO DELIVER BECAUSE OF BUYER'S INSOLVENCY; STOPPAGE IN TRANSIT OR OTHERWISE.

(a) A seller that discovers that the buyer is insolvent may refuse to make 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 shall hold and deliver the goods according to the directions of the seller. The seller is liable to the bailee or carrier for any resulting charges or damages. A carrier or bailee need not stop delivery if the seller does not provide indemnity for charges or damages upon the carrier's or bailee's demand.

(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 which the goods have been received for shipment or storage.

SOURCE: Sales, Section 2-705.

Notes

1. There are two revisions of substance in §2-818.

First, the power of a seller to refuse delivery to an insolvent buyer except for cash, previously stated in former §2-702(1) of the 1990 Official Text, is now expressed in §2-818(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. In addition, under subsection (d)(2), similar to § 2-705, the carrier or bailee need not stop delivery unless the seller provides indemnity for damages or charges upon the carrier's or bailee's demand. Given the deletion of the limitation of carload, truckload, or planeload, the carrier or bailee could be under the obligation to stop and incur damages to third parties for delay while the one package is dug out of the conveyance. A right to indemnity after the fact is merely the right to sue the seller for damages. This sentence gives the carrier or bailee the right to get indemnity up front before the harm is caused to anyone else.

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 2-819. 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 and incidental damages, less expenses avoided as a result of the breach.

(b) A resale:

(1) may be at a public auction 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 which has rightfully rejected or justifiably revoked acceptance shall account for any excess over the amount of the claim secured by the security interest as provided in Section 2-823(b).

SOURCE: Sales, Section 2-706.

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 §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 §9-504(3). Since a seller in possession may have a security interest arising under Article 2, §9-113, and the resale remedy is similar to the rights of a secured party, §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 §2-823(c). Notice in the latter cases is more important because the debtor has an interest in the goods sold (title) and owes a fixed amount of money. In the typical resale under §2-819, the buyer is normally not a debtor (the price is not yet due) and has no interest in the goods, although the buyer could have an interest if the goods are identified to the contract for sale prior to the buyer's breach. §2-502. 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 private 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. If the seller fails to give notice to the buyer in a public sale as required by §2-819(c)(2), should that preclude the seller from getting damages under this section if the sale was conducted in good faith, commercially reasonable and in a commercially reasonable manner? Or should the buyer merely have a claim for damages caused by the failure to give notice?

3. The relationship between §2-819 and §2-821 is important. Consider these variations where the goods are in fact resold:

(a) Resale in good faith and in a commercially manner. Section 2-819(a) is probably the preferred remedy. §2-821(b), however, is available in a lost volume situation. If the seller does not want to have its general damages set by this section, then the seller should not "identify the resale as referring to the breached contract under §2-819(b)(3). See proposed

comment under §2-803. In comparing the resale price-contract price differential with the market price-contract price differential, it is impossible to tell what puts the aggrieved party in a better position unless one presumes that one measure is more accurate than another. In line with the presumption of Article 2 that an actual substitute transaction is a better indication of the measurement of the full performance position than the hypothetical market price measure, that presumption should govern in the resale context as well. Lost volume sellers or others that want to use the measure under §2-821(b) should also avoid identifying the resale as referring to the breached contract. Section 2-821(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 §2-803(c). Thus, the fact that the seller has complied with §2-819(a) should not automatically foreclose the choice of market damages under §2-821(a). The question is, considering the resale, whether that choice puts the seller in a substantially better position than full performance would have.

(b) Resale in good faith but not in a commercially reasonable manner. Although §2-819(a) is not available, §2-821(a) may be used and, in a case of lost volume, damages under §2-821(b) are available.

(c) Resale in bad faith. Although not stated in the text, damages under §2-821(a) should be ~~are~~ available only if they are the substantial equivalent of damages that would have been available if the seller complied with §2-819(a). Should this principle be placed in the text or the comments?

4. If an action for the price is not available, §2-822(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 Article 1 and §2-803 as well as the particular requirements of §2-819. 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, §2-817(b); and (4) not existing and not completed until after the resale contract.

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 §2-819. 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 2-820. PERSON IN POSITION OF SELLER.

(a) person in the position of a seller: includes, as against a principal, an agent that has paid or become responsible for the price of goods on behalf of the principal or any person that 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.

Notes

There are no changes of substance in former §2-707 of the 1990 Official Text.

Subsection (2) has been reworded to make clear that a person in the position of the seller has all of the remedies of the seller and not just those few remedies listed in former §2-707.

SECTION 2-821. SELLER'S DAMAGES FOR NONACCEPTANCE, FAILURE TO PAY, OR REPUDIATION.

(a) ~~Subject to Section 2-812,~~ If a buyer breaches a contract, the seller may recover damages based upon market price, together with any incidental and consequential damages, less expenses avoided as a result of the breach, 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.

(2) If the case comes to trial before the agreed time for performance, the measure of damages for the performance due after trial 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].

(b) A seller may recover damages measured by other than the market price, together with incidental and consequential damages, including:

(1) lost profits, including reasonable overhead, resulting from the breach of contract determined in any reasonable manner; 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.

Notes

Revised §2-821 makes several important changes.

1. Subsection (a), which measures damages based upon market price, is subject to §2-803. Thus, a seller cannot choose subsection (a) if market damages (objective) puts it in a substantially better position than full performance by the buyer would have done (subjective). To illustrate, suppose the seller resells identified goods under §2-819(a) at or above the contract price or actually recovers the price under §2-822. Section 2-821(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 2-819(a) was \$1,000 and the difference between the contract price and the market price under 2-821(a) was \$1,200, the \$1,000 amount will control. Finally, if damages under §2-821(a) substantially 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 §2-821(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.

The introductory phrase of subsection (a) is stricken as this subsection is subject to all of the sections in part 8A, not just §2-812. §2-801.

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 §2-810(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 §2-803(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 for performance due after the time of trial 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 §2-712, 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 §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 bracketed words in subsection (a)(2) are designed to call attention to the issue of whether this measure and the measure under §2-826(a)(2) should be parallel. See the notes under that section for further discussion.

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 a fixed price, 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 §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 the seller would have 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 §2-803(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 substantially 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 §2-817(b); and (3) The seller is a "lost volume" seller. See the proposed comment after §2-803 for the relationship between the lost profit measure and market price damages.

The buyer may require a seller who has selected subsection (a) to use subsection (b) when the contract price less market price substantially 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 2-817(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. Diasonics, Inc., 826 F.2d 678 (7th Cir. 1987), on appeal from remand, 924 F.2d 709 (7th Cir. 1991). See also, John M. Breen, The Lost Volume Seller and Lost Profits Under UCC 2-708(2): A Conceptual, Linguistic Critique, 50 U. Miami L. Rev. 779 (1996).

SECTION 2-822. 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 that remains in control of the goods and sues for the price shall hold for the buyer any goods identified to the contract. If the seller is entitled to the price and resale becomes possible, the seller may resell the goods under Section 2-819 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 breached the contract by failing to make a payment when due, a seller that has sued for but is held not entitled to the price under this section may still be awarded damages for nonacceptance under Section 2-821.

SOURCE: Sales, Section 2-709.

Notes

1. No revisions of substance have been made in §2-822(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 §2-708.

The underlined language in subsection (b) makes it clear that the seller's resale is subject to the requirements of §2-819.

2. Note that former §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 §§2-805 and 2-806.

3. The seller may now claim specific performance under §2-807(a). If justified by 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, §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.

To resolve these concerns, 2-807(a) has been revised to provide that if the parties agree to specific performance as a remedy, a decree for the price may not be made unless the conditions of 2-822(a) are satisfied. (November, 1996).

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 §2-822, and there is no specific provision permitting recovery of the price.

[C. BUYER'S REMEDIES]

SECTION 2-823. BUYER'S REMEDIES IN GENERAL; BUYER'S SECURITY INTEREST IN REJECTED GOODS.

(a) If a seller is in ~~material~~ breach of the ~~whole~~ contract, or in breach of the whole contract under Section 2-710(c), the aggrieved buyer, with respect to ~~the undelivered balance due for~~, any goods involved may:

- (1) recover the price paid or deduct damages from price paid under Section 2-828;
- (2) cancel the contract under Section 2-808;

(3) cover and obtain damages as to all the goods affected, whether or not they have been identified to the contract, under Section 2-825;

(4) recover damages for nondelivery or repudiation under Section 2-826; ~~and~~

(5) if an acceptance of goods has not been justifiably revoked, recover damages for breach with regard to accepted goods under Section 2-827.

~~(b) If a seller fails to deliver or repudiates, the buyer may also:~~

~~(1) (6) recover identified goods under Section 2-824; or~~

~~(2) (7) in a proper case, obtain specific performance or replevy [recover] the goods under Section 2-807;~~

~~(8) enforce a security interest under subsection (b); or~~

~~(9) recover incidental and consequential damages under Sections 2-805 and 2-806.~~

~~(c) (b)~~ 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 2-705 and 2-706,~~ The buyer may hold the goods and resell them in the manner provided for an aggrieved seller under Section 2-819. The buyer shall give the seller reasonable notification of the intended resale.

SOURCE: Sales, Section 2-711.

Notes

1. Minor revisions were made in §2-823, which now conforms in style to §2-815 and is subject to all of the principles in Subpart A of Part 8. Stating any additional limitations in this section is thus not necessary. ~~Like 2-815, the power to cancel the undelivered balance of a contract depends upon a "material breach" of the whole contract, a term that is defined in 2-702.~~

2. The catalogue of available buyer remedies in subsection (a) has been expanded to include damages with regard to accepted goods, §2-827. Those remedies, although available under the 1990 Official Text, were not flagged in §2-811. Incidental and consequential damages are also recoverable under §§2-805 and 2-806. ~~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 §2-803. There is no reason to separate the buyer's

remedies into two groups and thus all of the remedies are listed in subsection (a). To determine whether the remedy is available, the specific section and Subpart A must be consulted.

3. Revised §2-823(b) creates a statutory security interest on behalf of the buyer in limited circumstances and for a limited amount. See §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 §9-504. Given that the buyer is exercising a security interest in the goods, should the buyer's resale be subject to the Article 9 resale provisions or should current law be continued and make the buyer comply with the seller's resale provisions in §2-819? Note that the buyer resells under 2-819(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. The buyer's rights under §2-823(b) are not subject to the buyer's rights to hold the goods for the seller under §§ 2-704 and 2-705. Rather, the buyer's obligation under those sections is subject to the buyer's rights under this subsection. Therefore, the subject to language in subsection (b) is deleted.

SECTION 2-824. PREPAYING BUYER'S RIGHT TO GOODS.

(a) A buyer that 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.

(b) If the requirements of subsection (a) are satisfied, the buyer's right vests upon identification of the goods to the contract for sale even if the seller has not then repudiated the contract or failed to deliver as required by the contract.

SOURCE: Sales, Section 2-502.

Notes

1. The scope of former §2-502 has been expanded. Previously, a pre-paying buyer could recover identified, conforming goods from a seller who became insolvent within 10 days after receipt of the first payment. Under revised §2-824, 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." Moreover, subsection (b) states that the buyer's rights vest upon identification, even though the seller is not in breach. Put differently, the rights vest conditionally but, if there is a breach, relate to the time of identification.

What about creditors of the seller? Revised 2-505(a) (Nov. 1996) states that the rights of creditors of the seller with respect to goods identified to the contract and retained and subject to the buyer's rights under 2-824 if those rights vest prior to the time when a creditor's in rem claim (judgment lien or security interest) attaches to the goods. Thus, if the buyer's rights vest (upon identification) before the creditor's claims attach, buyer gets possession from the seller free of

creditor claims. If, however, the rights vest after attachment, the buyer is subject to the attached interests unless it qualifies as a buyer in the ordinary course of business under Article 9.

2. Revision history. Both the PEB Study Group and the ABA Task Force favored the repeal of former §2-502 because 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 §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 §2-807 were established. See §2-505(a). Beyond that, protection would depend upon compliance with Article 9, which, in practice, may be difficult to do.

The Drafting Committee concluded, however, that pre-paying buyers, especially consumer buyers, should have some protection under Article 2. An early revision of §2-824 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 §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 §2A-522(2), in accord. Under this version, therefore, identified but nonconforming goods were not covered by §2-502.

At the January, 1994 meeting, the Drafting Committee expanded the scope of §2-824 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 §2-807.

The buyer rights under §2-807(c) and §2-824 now look very similar. Under §2-807(c), the buyer may recover goods from the seller that are identified to the contract if the buyer is unable to get cover. Presumably if the buyer gets the goods, the buyer must pay the seller the contract price, i.e. render the buyer's performance. Under §2-824, if goods are identified to the contract, the buyer that has paid the price in part or full can recover the goods from the seller. What situation covered by §2-807(c) would not already be subsumed under §2-824? In addition, should the principle of §2-824(b) apply under §2-807(c) as well?

The November, 1996 Draft of 2-505 and 2-824, influenced by recommendations of the ABA/UCC Subcommittee, clarified when the buyer's right to possession vested so as to take free of the attached claims of the seller's creditors.

3. 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 §2-824, by applying to both situations, requires the buyer to tender the full contract price before identified but unfinished goods can be recovered. The extent to which a financing buyer can perfect a purchase money 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).

5. **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 §2-824 is now closer to Article 46(1) in granting the buyer what amounts to specific

performance. See CISG Art. 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 ."

SECTION 2-825. 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 that covers in the manner required by subsection (a):

(1) 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; and

(2) may not recover damages under Section 2-826.

(c) A buyer that does not cover or that covers in good faith but fails to cover in a manner required under subsection (a) is not barred from any other available remedy.

SOURCE: Sales, Section 2-712.

Notes

1. There are no changes of substance in former §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." However, a buyer who "covers" and satisfies subsection (a) is barred from recovering damages under 2-826. This follows the case law and is a change from the July, 1996 Draft, which provided that the buyer who covered could sue for market damages unless those damages put it in a substantially better position than full performance.

As in §2-819, a buyer who covers in bad faith may be limited to the damages that would have been recovered by a good faith cover under §2-825(b). See §2-803(c). To make that exception to subsection (c), the underlined language in that section has been added.

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 2-826. BUYER'S DAMAGES FOR NONDELIVERY OR REPUDIATION.

(a) If a seller breaches a contract, the buyer may recover damages based on market price, together with any incidental and consequential damages, less expenses avoided in consequence of the seller's breach, as follows:

(1) If the case comes to trial after the agreed time for performance, the measure of damages is the market price for comparable goods at the time of the breach [time for performance] or when the buyer learned of the breach, whichever is later, less the contract price.

(2) If the case comes to trial before the agreed time for performance, the measure of damages for the performance due after trial is the market price of comparable goods at the time [when a commercially reasonable period] after the buyer learned of the breach [expired] less the contract price.

(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.

Notes

1. Section 2-826, like §2-821 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 §2-821(a), choice by the buyer of §2-826(a) is limited by the remedial policy in §2-803(c): It must not put the buyer in a substantially better position than full performance would have. This approach rejects cases like *Tongish v. Thomas*, 840 P.2d 471 (Kan. 1992), holding that the specific terms of §2-713(1) of the 1990 Official Text control the general remedial limitations in §1-106(1). The reference to §2-812 is deleted in subsection (a) as all of the principles in part 8A control the specific remedial provisions in parts 8B and 8C, not just the principles in §2-812. §2-801. See the proposed comment following §2-803 on the most

“accurate measure of the full performance position. The mitigation principle in §2-803 also serves to control the buyer’s remedial choices.

On the other hand, a buyer who properly covers under 2-825(a) is precluded from seeking damages under 2-826(a). See 2-825(a)(2).

2. Subsection (a)(1) follows the approach to damages taken in §2-821(a)(1) where the case comes to trial after the agreed time for performance. The objective is to tie the market price to the time of the breach (whether by repudiation or non-performance) unless the buyer did not learn of the breach until later. 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. Similarly, if the seller repudiated on September 15 and the buyer did not learn of the repudiation until October 1, October 1 is the date to measure damages. These are the first times when the buyer could have taken remedial action, even though no action was taken. Assume the time for the seller’s tender is Oct. 1 and the seller repudiates September 15. The buyer learns of the repudiation on September 15 but is unable to cover. Is the time of the seller’s breach September 15 or Oct. 1? See §2-814(b). In this situation, shouldn’t the buyer’s damages be measured at the time of tender, Oct. 1?

3. Subsection (a)(2) follows §2-821(a)(2) when the case comes to trial before the agreed time for performance. In the July, 1996 Draft, the time for measuring market price was when a "commercially reasonable time after the buyer learned of the repudiation has expired." See §2-713. Thus, market price was 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 §§2-811 and 2-821.

The November, 1996 Draft simplifies by selecting the time when the buyer learned of the breach (invariably a repudiation) regardless of whether the buyer had a valid reason for not covering or cover was reasonable on that date. There are no nuances here and the tool for combating strategic behavior is left to that valiant soldier, good faith. The bracketed words in subsection (a)(2) parallel §2-821 in this draft. At issue is whether the buyer and seller situations should be treated differently. Under former §2-713 and §2-723(1), if the case came to trial before the time for performance, the market price was measured when the buyer learned of the breach. This was criticized as being inconsistent with the anticipatory repudiation sections which allowed an aggrieved buyer to await the seller’s performance for a commercially reasonable time. Thus, the policy issue is whether the default for measuring market price for the performance due after trial should be at the time the buyer learned of the repudiation or at the end of the commercially reasonable time after the repudiation when the case comes to trial before the time for performance. Keep in mind the overriding mitigation principle stated in §2-803 that should help to control strategic behavior to some extent.

4. In cases where the case comes to trial before the agreed time for performance (breach by repudiation), neither 2-821 nor 2-826 use the phrase “contract price in a restrictive sense. There are no “snap shots here. Thus, if the agreed price contains escalation provisions, the court must attempt to interpret and apply them to the case.

5. **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 2-827. BUYER'S DAMAGES FOR BREACH REGARDING

ACCEPTED GOODS.

(a) A buyer that has accepted goods and given notice pursuant to Section 2-707(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) The 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 recover incidental and consequential damages.

SOURCE: Sales, Section 2-714.

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 2-827 applies when the buyer has accepted the goods, §2-706, and has not justifiably revoked acceptance under §2-708. Subsection (a) states the general damage rule, see §2-804, 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 §§2-805 and 2-806 are recoverable in addition to damages under §2-827.

3. Subsection (b) has been frequently litigated, with sometimes puzzling results. The key measure for breach of a warranty of quality, i.e., §§2-403, 2-2-406 and 2-407, 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 , 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 2-827(b) with the buyer's power to reduce the price granted in §2-828.

SECTION 2-828. 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 from any part of the contract price still owed under the same contract.

Source: Sales, Section 2-717.

Notes

There are no changes of substance in former §2-817 of the 1990 Official Text. Compare CISG Art. 50.

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