

March 1, 1997

To: Article 2 Drafting Committee; ALI Sales SubGroup
From: Richard E. Speidel, Reporter
Re: Status of Article 2 revision

Here overview of the March 1, 1997 Draft of Article 2. This 1997 Draft incorporates changes made in the November, 1996 Draft which were made at the January, 1997 meeting of the Drafting Committee.

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

Part 1. General Provisions

Section 2-101. Short Title

Section 2-102. Definitions

(a)(4) Cancellation. This definition is elaborated in 2-808.

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

See Notes. This definition illustrates the occasional tension between the drafts of Articles 2 and 2B. The issues were discussed with the ALI Sales Consultative Group, with emphasis on whether conspicuous should be decided by a court rather than a jury (Article 1 and 2B so provide) and whether a clearer "safeharbor" should be provided. Ultimately, this definition should be in Article 1. See 1-201(12) (1997).

(a)(9). Consumer contract. See 2-102(a)(8) for a definition of consumer.

(a)(16) A elaborate definition of "foreign exchange transaction" is provided. This transaction is excluded from Article 2. See 2-103.

(a)(18). Good faith. This definition follows 3-103(a)(4) and was approved at the 1996 annual meeting of the Conference. See 1-201(23) (1997).

(a)(19). Goods. Obligations created by "foreign exchange transactions" are not goods and are excluded in 2-104(d).

Note that Section 2-103 (July, 1996), defining the concept of "manifesting assent," was deleted at the November, 1996 meeting of the Drafting Committee. For the reason why, see the discussion after Section 2-206, **infra**. See 2B-112 & 113.

Section 2-103. Scope.

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

provides, this Article applies to transactions in goods. The scope issues involving mixed goods and services, previously covered in sub. (a)(1) and (a) (2), are left to judicial development.

The service agreement defined in sub. (a)(3) was also excluded from Article 2. Thus, 2-602, which provided more detail on performance and enforcement of these contracts, is also deleted. In essence, the concern was that issues unique to service contracts might be included in Article 2 without adequate study. The recent changes reflect a judgment that these transactions, particularly service agreements, should not be covered by a code, even though a sale of goods is involved. A court, however, may still apply Article 2 by analogy.

Should “foreign exchange transactions” be excluded from Article 2? 2-103(d).

Section 2-104. Transactions Subject to Other Law.

See 2-104(a)(1), which adopts the approach to the mesh with state certificate of title statutes suggested at the January, 1997 meeting of the Drafting Committee..

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

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

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

A survey of cases under 2-105 [2-302 in the 1995 Official Text] over the last ten years reveals that courts rarely find a contract or clause unconscionable.

Should the unconscionability provision be moved to Article 1? See 1-306 (1997).

Section 2-108. Effect of Agreement.

Subsection © is former 2-107 of the July, 1996 Draft.

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

Section 2-201. No Formal Requirements.

The 1996 Annual Meeting (faced with a unanimous Drafting Committee) again rejected a motion to restore the statute of frauds. The vote was 65-52.

The Drafting Committee, in November, 1996, however, agreed that some version of current 2-201 should be restored and a draft section appears in the March, 1997 Draft.

Why this reversal? Assuming that one concludes that a statute of frauds is not needed in

sales contracts to weed out perjured claims (and that use of the defense often promotes fraud), several reasons are given to retain the statute: (1) Article 2 should be consistent with 2A and 2B, which have statutes of frauds; (2) The presence of the statute tends to channel behavior toward reducing agreements to writing; and (3) The statute of frauds defense is a proxy for resolving contract formation issues on a summary judgment motion.

The Reporters are not persuaded. Professor Caroline Brown, who has just completed the Corbin volume on the statute of frauds, has concluded: “It is impossible to read the huge body of case law without becoming convinced that the statute’s role is principally an evasive device for contract breachers. If so, why retain it?”

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

Subsection (a) deals with the legal effect of an integrated writing. The important question is how to determine whether the writing is integrated if there is no merger clause and, if a partial integration, what prior or contemporaneous agreements are excluded. The current draft assumes an integration if earlier terms contradict those in the writing. If, however, the earlier term, if agreed to, would not certainly have been included in the writing, the writing is not integrated as to that term. This is a more precise statement of the “consistent additional term phrase in the current 2-202.

Subsection (b) has been revised again for discussion.. See Note 2.

Section 2-203. Formation in General.

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

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

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

The policy implications are that in commercial cases, including those involving small businesses, the question whether a party has agreed to terms in a standard form is determined under the usual standards of agreement or assent. The requirement of an “opportunity to review,” contained in the definition of “manifest assent” in deleted 2-103 no longer applies. To put the matter differently, although the commercial world is full of standard forms and standard terms [as defined in 2-102(a)], revised Article 2 provides no special rules to deal with them. The risk of unfair surprise and unreasonably favorable terms is left to the unconscionability doctrine, 2-105.

2-204. Firm Offers.

The last sentence should be revised as follows: “A term of assurance in a record supplied

by the offeree to the offeror is ineffective unless the term is conspicuous.

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

In subsection (a)(1), an offeree can create a contract by a definite acceptance in a record that contains terms that vary the offer. See 2-207(1) (1995) and Note 1 and Examples.

See Note 4 for a discussion of recent cases.

2-206. Standard Form Records.

Section 2-206 deals with what terms are included in consumer contracts. This is the second redraft of the section, which was approved in principle at the November, 1996 meeting of the Drafting Committee.

Section 2-206(a) (July, 1996), which dealt with standard forms in commercial contracts, was deleted at the November, 1996 meeting of the Drafting Committee, along with the concept of “manifest assent” in 2-103. Thus, a commercial party who signs or otherwise assents to a standard form or a record containing standard terms is bound unless the contract or terms are unconscionable under 2-106.

Note that the current draft of Article 2B develops special rules for assent to standard form contracts and for the so-called “mass market” transactions. The concept of “manifests assent” is crucial to these rules.

Consumer Contracts.

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

At the November, 1996 meeting of the Drafting Committee, the essence of 2-206(b) was preserved with elaboration in a new Section 2-206 dealing with standard forms in consumer contracts. **See the current draft and notes, which provides three alternatives for discussion.**

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

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

Section 2-207. Effect of Varying Terms.

See the current draft and notes. Note that 2-207's application is limited to two situations (it does not provide a universal rule for term inclusion) and does not distinguish between records and terms that may be standard forms or standard terms. Nor does it require "express agreement for inclusion. Rather, if the terms of one party are excluded under the rules of 2-207(1) and (2), they cannot be included under other principles of agreement if inclusion "would result in unfair surprise or hardship to one party. This is the test used by most courts and its application is left to the courts in particular cases.

What is the antidote to the risk that a court will, after the fact, find unfair surprise? The answer is to neutralize the risk of unfair surprise at the time of contracting.

Query: If this version of evolving 2-207 is acceptable to all, is any version of 2-207 required? If contract formation issues are covered in 2-203 and 2-205, would it be better simply to declare victory over the "battle of the records" and leave the question of "what terms" to the courts under the general principles of agreement, limited by the unconscionability section?

Section 2-208. Electronic Transactions: Formation

_____ See 2B-206 and 2B-205(e).

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

_____ This section will probably be moved to Article 1. See 1-304(a) (1997).

Section 2-210. Modification, Rescission, and Waiver

See revised text and notes.

Section 2-211. Electronic Messages; Attribution.

Conform to 2B.

Section 2-212. Intermediaries in Electronic Messages.

Conform to 2B.

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

Part 3. General Obligation and Construction of Contract.

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

Section 2-301. How Price Payable.

Section 2-302. Transfer at a Single Time.

See Note 1.

Section 2-303. Open Contract Price Term.

See Note 2.

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

Subsection (a) intends to say that if a party has no output or no requirements in good faith, the “quantity unreasonably disproportionate” clause does not apply. In short, you can go out of business in good faith without fear that the failure to have output or requirements is unreasonably disproportionate to stated estimates or the like.

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

Section 2-306. Time for Performance Not Specified.

See Note 1.

Section 2-307. Options and Cooperation Respecting Performance.

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

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

See the “policy question” at the end of the notes.

Section 2-310. Termination; Survival of Obligations.

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

Section 2-311. Termination; Notice.

See Note 1.

Section 2-311. Auctions.

See revised Notes.

Part 4. Warranties.

In addition to a separate Part 4, there are a number of changes from the July, 1996 draft that affect the scope of warranty and liability for breach of warranty. The Drafting Committee made even more changes at the November, 1996 and January, 1997 meetings. The March, 1997 draft is the latest effort.

Section 2-401. Definitions.

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

Note that damage includes “injury to a person or property” resulting in the ordinary course from a breach of warranty. 2-401(1).

Personal injury and property loss resulting from breach of warranty.

Here is an overview of how the March, 1997 Draft treats personal injury and property loss resulting from an alleged breach of warranty.

1. Privity of Contract.

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

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

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

Third, Section 2-319 in the July, 1996 and Section 2-411 in the November, 1996 Draft have been deleted. Except for 2-401(a), 2-806 (consequential damages) and 2-810© (exclusion of liability for consequential damages), personal injuries are neither mentioned nor given special treatment. No attempt was made to draft law for the handful of states that use Article 2 in lieu of strict tort liability.

Fourth, the text of revised Article 2 does not state when the applicable tort law preempts warranty law in Article 2. Although some guidance is given in the comment to 2-406 (the comment is still open for discussion), the question is left to the courts. To the extent that the goods are defective, tort law should be available. To the extent that express or implied warranties are made that are broader than the tort test for defect, Article 2 should apply. The Drafting Committee was reluctant to restrict judicial flexibility, particularly where contract expectations are the basis for the claim. Thus, the remote possibility exists that goods that are not defective under tort standards (i.e., no design or manufacturing defect) may still be unmerchantable.

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

2. No privity of contract.

Suppose S#1 manufactured a component, sold it to an "immediate buyer" (S#2) who installed the component in equipment and sold the equipment to a dealer (S#3) who resold it to a remote buyer. See 2-401. A condition in the component or the manufactured goods caused injury to the remote buyer and employees in the place of business and property other than the goods sold. Can these losses be recovered from S#1 or S#2 under revised Article 2 by either the remote buyer a transferee or the employee? The answer is no unless the conditions of 2-404 or 2-409 are met.

Section 2-404(a) is limited to affirmations or promises made to a remote purchaser through an intermediary who is not an agent. Implied warranties are not included here. If a direct obligation is created and breached and there are no valid limitations on rights and remedies, a remote purchaser could recover for damage to person or property. Subsection (d)(3). The employee, however, could not.

Section 2-404(b) is limited to affirmations, samples or models and promises made to a remote purchaser in a “medium for communication to the public, including advertising. Implied warranties are not included here. If a direct obligation is created and breached, the remote purchaser could recover for damage to person or property. The employee, however, could not.

In addition to 2-404, 2-409 contains three ways that an express or implied warranty might be extended to a remote purchaser or transferee and, if breached, support a claim for damage to person or property:

(1) Subsection (a) is a derivative warranty based upon 2-318© of the 1995 Official Text. The seller is protected from personal injury and property damages in two ways, (1) an exclusion of consequential damages valid against the immediate seller is valid against a remote purchaser or transferee, and (2) liability does not extend to persons who are not purchasers or transferees. Thus, an employee of a remote purchaser could not recover.

(2) Subsection (b)(1) protects certain beneficiaries, assignees and transferees by operation of law.

(3) Subsection (b)(2) does not displace other principles that courts might use to extend warranties express or implied.

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

See notes to the revised text.

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

Section 2-403. Express Warranties.

After the November, 1996 meeting, 2-403, which dealt with express warranties to an immediate buyer was revised for clarity. The history and purpose are stated in the notes.

The revision uses the phrase “immediate buyer” in 2-403 and “remote purchaser,” which is defined to include a “remote buyer or lessee,” 2-401(4), in 2-404. Protection is also extended to transferees in both sections.

Under sub. (a), descriptions, affirmations, samples, models or promises that become part of the agreement create an obligation that the goods will conform “unless a reasonable person in the position of the buyer would “believe otherwise [i.e., that the affirmation was not part of the agreement] or “would believe that what the seller said or did was “puffing.

Subsection (b) states that an obligation under (a) may be created by advertising, sub. © downplays the need for formal words of warranty or guaranty and sub. (d) states when an obligation is breached upon tender of delivery.

See notes.

Section 2-404. Express Warranty Obligations to Remote Purchasers and Transferees Arising Other than as Part of an Agreement of Sale.

This section combines Sections 2-404 and 2-405 into one section dealing with the liability of sellers to remote purchasers and transferees for express warranties and promises made through intermediaries or through communications to the public. The obligation is imposed without an agreement between the remote purchaser and the seller but is treated in most ways as if an express warranty has been created.

This important section is new. Please review the text and notes.

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

See the Note on Personal Injury and Property Loss, supra., and comment 3.

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

Section 2-407. Disclaimer or Modification of Warranties.

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

The general disclaimer principle for commercial contracts is stated in subsection (b).

The “safeharbor” for disclaimers in a record is stated in subsection (c). The language must be conspicuous and satisfy the conditions in (c)(1), (2), or (3). The revision responds to decisions by the Drafting Committee in January, 1997 and a renewed attempt to install order.

Disclaimers of implied warranties in consumer contracts are treated in subsection (e).

Section 2-408. Cumulation and Conflict of Warranties.

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

In addition to 2-404, express and implied warranties might be extended to remote purchasers and transferees under 2-409. There are three possibilities, derived warranties, subsection (a), beneficiaries, assignees and transferees by operation of law, subsection (b)(1), and judicial development, subsection (b)(2).

The “substantial interest” in subsection © exception was approved at the January, 1997 meeting.

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

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

Unique to Article 2.

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

Section 2-503. Assignment of Rights.

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

Subsections (a), (b) and © are, in the main, former Section 2-210 (1995 Official Text). Subsections (e) and (f) state when attempts to prohibit assignment of rights and delegation of duties by agreement are effective and the consequences of such attempts. Beyond that, 2-403 does not go.

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

Section 2-504 is subject to state certificate of title laws to the extent stated in 2-104(a). With the exception of buyers in the ordinary course of business, the assumption is that 2-504 operates unless the applicable certificate of title law states a different rule.

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

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

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

This section, as revised, when combined with revised 2-724, makes a major change in the law. This change is subject to final coordination with the Article 9 Drafting Committee.

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

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

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

Part 6. Performance

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

little discussion.

Section 2-601. General Obligations.

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

Section 2-602, Service Agreements Relating to Goods, which appeared in the July, 1996 Draft, has been deleted.

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

See note 3, where the proper time for determining when a tender of delivery conforms to the contract is discussed.

Section 2-603. Shipment by Seller.

See Notes for revisions made after the September, 1996 meeting of the Drafting Committee. The section was conformed to CISG Art. 31(a) and Art. 32.

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

Section 2-605. Rights of Financing Agency.

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

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

Section 2-608. Payment by Buyer Before Inspection.

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

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

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

Section 2-612. Risk of Loss.

Although the basic approach of former 2-509 has been retained (i.e., that risk of loss should be on the party in possession or control of the goods), there is some disagreement about the extent to which a party's breach should, in the absence of contrary agreement, affect the risk allocation. Former 2-510 did so explicitly, but that section was deleted from earlier drafts.

The two alternatives to 2-612 pose this question for final resolution.

Alternative A starts from the premise that it is irrelevant whether the tendered goods conform to the contract, but in subsection (e) provides different rules in some cases where a party is in breach. In these limited cases, the risk is allocated to the breaching party without regard to whether either actually had insurance.

Alternative B starts by requiring conforming goods for risk to pass, but in subsection (d) provides even more complex rules for reallocating risk upon

breach.

What policy should prevail? The Reporters prefer Alternative A because it minimizes the effect of breach. An even better draft would further limit the reallocative effect of a breach to cases where the breach caused or contributed to the loss.

Part 7. Breach, Repudiation, and Excuse

Section 2-701. Breach Generally.

Breach is defined in subsection (a).

A test for determining whether there has been substantial impairment of value by a breach is stated in subsection (c).

Section 2-702 of the July, 1996 Draft, which used the concept of “material breach,” has been deleted. The phrase “material breach” has been deleted from the draft.

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

This section, which is new, combines in one place several areas where action or inaction by an aggrieved party may waive remedial options. See Notes. For example, Section 2-704 of the July, 1996 draft, which dealt with “waiver of buyer’s objections by failure to particularize,” is now found in subsection (d).

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

_____ The “perfect tender rule,” such as it is, has survived. In addition to the cited sections, the rejection remedy is limited by the duty to enforce a contract in good faith and by contrary agreement by the parties. It is best viewed as a demand for “cure” rather than as a first step to cancellation.

Subsection (b) requires timely notice to make a rightful rejection effective.

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

Subsection (b)(2) deals with the buyer’s obligation to pay for goods used after a rejection or revocation of acceptance.

The buyer’s duties with regard to the seller’s goods apply to both rejection and revocation of acceptance cases.

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

Section 2-706. What Constitutes Acceptance of Goods.

Section 2-707. Effect of Acceptance; etc.

Subsection (c)(1) has been revised for clarity. The goal is to avoid a draconian result when there is a failure to give prompt notice of breach. The burden is on the seller to establish

that it was prejudiced (and how) rather than the other way around.

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

Section 2-708. Revocation of Acceptance.

Section 2-709. Cure.

If the buyer rightfully rejects or justifiably revokes under 2-708(2) before the time for performance has expired, the seller has a broad right to cure within the agreed delivery time. Subsection (a).

After the time for performance has passed, the seller's right to cure is stated in subsections (b) and (c). The scope of that right has been much debated. In subsection (b), Alternative A represents the current view of the Drafting Committee. Alternative B is another way of reaching essentially the same result.

Subsection (d) applies in every case.

In essence, if the seller makes a nonconforming tender the buyer must either accept or reject the goods. If the tender is rejected (regardless of the degree of nonconformity) and notice is given (otherwise it would be an acceptance), the seller has a right to cure under 2-709. The buyer cannot cancel and pursue other remedies, such as cover, until the seller has failed to cure (broadly defined). The buyer breaches by depriving the seller of the statutory right to cure.

See notes on "cure" under CISG and the Unidroit Principles.

Section 2-710. Installment Contract; Breach.

The definition of "installment contract" has been sharpened.

The effect of the buyer's breach of an installment contract is not specifically covered in subsection (b).

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

Section 2-712. Anticipatory Repudiation.

See Notes. Repudiation is defined.

Section 2-713. Retraction of Anticipatory Repudiation.

2A and 2B should conform to 2-714.

Section 2-714. Casualty to Identified Property.

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

Section 2-715. Substituted Performance.

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

There are no major changes in this important section.

The buyer's excuse claims based upon frustration of purpose and similar defenses, which were treated in an earlier draft, have been removed from 2-716 and left to the common law. See Notes.

Section 2-717 . Procedure on Notice Claiming Excuse.

Part 8. Remedies

[A. In General]

Note: The Drafting Committee will start with Part 8 at its March, 1997 meeting.

Section 2-801. Subject to General Limitations.

Section 2-802. Breach; Procedures.

Section 2-803. Remedies in General.

See Notes, particularly Note 4.

A court is directed in subsection (a) to protect the plaintiff's expectation interest. There are several ways (remedies) to achieve that result for both seller and buyer. The policy is to permit the plaintiff to pick the most appropriate remedy subject to the general limitation in subsection (c). The notes elaborate on the implications of choice and how a court might decide that a particular choice overcompensates the plaintiff.

Section 2-804. Damages in General.

This section, which is new, provides "back up" remedies when all else fails.

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

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

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

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

recognized in Section 2-821.

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

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

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

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

In sum, Article 2 does not define direct damages for a simple reason: If damages are neither incidental nor consequential they are, in effect, direct. An attempt to be more precise is not recommended. See Notes to 2-806.

Section 2-805. Incidental Damages.

The incidental damages for both seller and buyer are combined into one section.

Section 2-806. Consequential Damages.

The “unreasonably disproportionate” language in 2-806(3), although subject to extensive discussion, survived a sense of the house motion to delete it. It is now limited in effect to economic loss and damage to property.

The current draft tries to state in one section what has been agreed to by the Drafting Committee. See notes. The changes are, (1) the defendant must also have reason to know that the loss would “probably result” from the breach, (2) the defendant may establish that the loss was unreasonably disproportionate to the risk assumed, and (3) injury to person or property resulting from a breach (not breach of warranty) need not proximately result from the breach.

The battle for consequential damages is reflected in the notes.

Section 2-807. Specific Performance.

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

The remedy in subsection © works even though the buyer is not entitled to recover the goods under 2-824.

Section 2-808. Cancellation; Effect.

_____ This section is new.

Section 2-809. Liquidation of Damages; Deposits.

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

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

Subsection (b)(2) is restored.

Section 2-810. Contractual Modification of Remedy.

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

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

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

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

Section 2-811. Remedies for Misrepresentation and Fraud.

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

Section 2-812. Proof of Market Price.

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

Section 2-814. Statute of Limitations.

Subsection (a): (1) Identifies three other sections where different statutes of limitations are stated; (2) Includes actions for breach of indemnity in Section 2-814; and (3) Clarifies that in “no

case may the four year statute be extended by agreement.

Subsection (c)(3) states when a cause of action for breach of indemnity occurs.

[B. Seller's Remedies]

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

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

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

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

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

The adequacy of this draft when the rights of unsecured sellers in bankruptcy are considered will be reviewed.

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

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

Section 2-819. Seller's Resale.

The seller is not required to notify a breaching buyer before conducting a private resale.

A resale that complies with subsection (a) should preclude the seller from suing for contract price\market price damages.

Section 2-820. Person in Position of Seller.

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

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

The measure of damage for repudiation by the buyer of a long-term contract is stated in subsection (a)(2). See Note 3. The bracketed language indicates that a final decision has not been made on the time for measuring market price when the breach is by repudiation and the case comes to trial before the time fixed for performance. The bracketed language is favored by the Reporters.

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

Section 2-822. Action For Price.

[C. Buyer's Remedies]

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

See the comments to 2-715, which apply here as well.

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

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

The definition of BIOCB is critical. Should that status arise under 2-824 when the buyer obtains a special property interest and other conditions are met?

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

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

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

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

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

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

The phrase "less the contract price" includes flexible price provisions. Thus, the court must try to determine the effect of, say, an escalation clause, when measuring damages under subsection (a).

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

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

Section 2-828. Deduction of Damages From Price.

