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A SURVEY OF PART 5 OF REVISED ARTICLE 2

*Patricia A. Tauchert**

IN some respects this Symposium comes at a difficult juncture in the process of revision of Article 2 of the Uniform Commercial Code ("UCC"). The revision of Article 2 has been an unusually extended process. It began in 1988 with the appointment of a study group. The Drafting Committee was formed in 1992 and went through several permutations while considering a "hub and spoke concept." That concept was abandoned in 1995, and a drafting committee for what ultimately became the Uniform Computer Information Transaction Act ("UCITA") was spun off as a separate committee. The drafting process for Article 2 continued on a sometimes rocky road until today. A draft was approved in May 1999 at the American Law Institute ("ALI") annual meeting, over some objections. That draft, dated July 1999 ("the July 1999 Draft") was submitted for final approval to the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the co-sponsor of the UCC (with the ALI), at NCCUSL's July 1999 annual meeting. NCCUSL withdrew the July 1999 Draft from consideration for final approval at its annual meeting in response to concerns that the proposed changes were too controversial, and that the Draft was probably not enactable on a reasonably uniform basis.

The July 1999 Draft had received widespread criticism for the number and extent of the changes, as well as for the positions taken on a number of substantive issues. Criticism came from commercial, consumer, and academic sources, and no group offered strong support for the proposed revisions. Very substantial revisions were made to the July 1999 Draft to address the concerns of those who believe that the existing Article 2 continues to be a workable law and that, while some changes are justified to reflect changes in the marketplace, the sweeping changes of the July 1999 Draft were not justified.

The result was the July 2000 Draft. While still containing very significant changes to current law, the July 2000 Draft is far more consistent with existing law. It was read at the 2000 ALI Annual Meeting, but not considered for adoption. It was presented for final approval at NCCUSL's August 2000 Annual Meeting, but was again withdrawn in re-

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sponse to continued concerns about some of the proposed revisions. The most notable concerns were those concerning the application of Article 2 to software embedded in or related to goods and the interrelationship between Article 2, UCITA, Uniform Electronic Transactions Act ("UETA"), and proposed federal legislation on electronic contracting; and concerns about the creation of warranty rights for remote parties as a result of advertising.

As a commercial practitioner, I would like to express support to NCCUSL for having the courage to make the move to withdraw the July 1999 Draft and applaud its efforts, painful as they are, to reconcile the need for change with the need for stability. This is an extremely difficult task. The process demonstrates the continuing commitment of NCCUSL to presenting the states with commercial law that reflects commercial practices and facilitates the flow of business, while maintaining neutrality between the parties.

Karl Llewellyn remarked in 1938 that commerce had become so complicated that it was necessary to separate mercantile concerns from other aspects of commerce in order to appropriately address those concerns.¹ Commerce has become increasingly complex in the ensuing sixty-two years and it is truer now that one rule cannot address all the nuances of every aspect of trade. Perhaps the central problem with the July 1999 Draft revision of Article 2 is that it attempted too much. Particularly troubling was the attempt to integrate consumer protection concerns into Article 2 without separation or identification of the issues as consumer protection issues. This approach was perceived to increase the enactability of consumer protection in states which have traditionally resisted such reforms, but it seriously impaired the viability of the July 1999 Draft as a general-purpose statute. No matter what one's position is with respect to appropriate consumer protections, a buyer-protection bias is inappropriate in a commercial transaction where the buyer often has the greater economic leverage. One cannot justify giving Ford Motor Company or Wal-Mart the same protection one would afford to a consumer.

Article 2 remains a general-purpose statute and one that is vitally important to all sales of goods in the United States economy. Many transactions, both consumer and commercial, are conducted on an informal basis without extensively negotiated contracts, and often with only very sketchy documentation. Article 2 is critical to maintaining the efficiency of the marketplace. The impact of Article 2 seems to have diminished over time only because it has been so effective as a codification of generally accepted commercial practice.

Stability in commercial law (or evolution rather than revolution), will continue to be important in the years ahead. The July 2000 Draft made great headway in addressing the need for evolutionary rather than revolutionary change. This more conservative approach in the new draft is

1. See generally Karl N. Llewellyn, *Through Title to Contract and a Bit Beyond*, 15 N.Y.U. L. REV. 159 (1938).

important in light of proposed liberalizations of the statute of frauds in Section 2-201, the expansion of parol evidence rule in Section 2-202, formation rules in Section 2-204, and the reformulation of the Battle of the Forms provisions of Section 2-207, as well as important changes to warranties and remedies.

Changes to those sections operate by law rather than by agreement, and cannot be altered by agreement of the parties. It is likely that Article 2 will be even more important in the interpretation and implementation of a wide range of sales transactions as a result of the revision process. It is critical that Article 2 continue to be a balanced, neutral vehicle for the implementation and interpretation of commercial agreements. The July 2000 Draft, although still the subject of controversy, has made great progress toward that goal.

This article deals with changes by the July 2000 Draft to Part 5 (Performance) of current Article 2. Part 5 is somewhat prosaic, and has not been the subject of much controversy, but three changes are notable. Two changes are important for what *was* done, the expansion of the seller's right to cure and a prepaying buyer's right to claim goods. The third change is important for what was *not* done; the July 2000 Draft retains Section 2-510 on the Effect of Breach or Risk of Loss. In each instance, the July 2000 Draft serves the function of commerce well.

The proposed changes to Section 2-502, Buyer's Right to Goods on Seller's Insolvency, and Section 2-508, Cure by Seller of Improper Tender or Delivery; Replacement, relate to provisions which have not been widely litigated, and make changes which have been suggested in the commentary, but are not addressed with particularity in the case law. As a consequence, the effect of the changes is difficult to predict, and only a cursory review is possible at this time. For ease of reference, the text of Section 2-502 and Section 2-508 in both the Official Text and July 2000 Draft version are reproduced below in the notes.²

2. References are to the Official Text of the Uniform Commercial Code (1994) ("Official Text") and to the July 2000 Draft for all revised sections.

Official Text Section 2-502 Buyer's Right to Goods on Seller's Insolvency

(1) Subject to subsection (2) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

U.C.C. § 2-502 (1994).

Official Text Section 2-508 Cure by Seller of Improper Tender or Delivery; Replacement

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

The July 2000 Draft Section 2-502 greatly expands a pre-paying consumer's right to obtain specific performance of the sale agreement. The revision both eliminates the requirement under present law that the seller become insolvent within ten days after receipt of the first installment of the price, and extends the basis of the claim for the goods from insolvency alone to insolvency, repudiation, or failure to deliver. This is a very significant departure from present law. In order to obtain the benefit of revised Section 2-502, a pre-paying consumer must tender any remaining portion of the unpaid price. Revised Section 2-502 further requires, as does current law, that the goods be the subject of a "special property" of the buyer created by Section 2-501. Section 2-501 has not been substantively modified in the July 2000 Draft.³ Revised Section 2-502 further

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

U.C.C. § 2-508 (1994).

July 2000 Draft Section 2-502 Buyer's Right to Goods on Seller's Repudiation, Failure to Deliver or Insolvency

Subject to subsections (b) and (c) and even though the goods have not been shipped a buyer that has paid a part or all of the price of goods in which the buyer has a special property under Section 2-501 may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

in the case of goods bought for personal, family, or household purposes, the seller repudiates or fails to deliver as required by the contract; or
in all cases, the seller becomes insolvent within 10 days after receipt of the first installment on their price.

The buyer's right to recover the goods under subsection (a) vests upon the acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

If the identification creating the special property has been made by the buyer, the buyer acquires the right to recover the goods only if they conform to the contract for sale.

U.C.C. § 2-502 (Proposed Official Draft 2000).

July 2000 Draft Section 2-508 Cure by Seller of Improper Tender or Delivery; Replacement

Where the buyer rejects goods or a tender of delivery under Section 2-601 or 2-612 or except in a consumer contract justifiably revokes acceptance under Section 2-608(a)(2) and the agreed time for performance has not expired, a seller that has performed in good faith, upon reasonable notice to the buyer and at the seller's own expense, may cure the breach of contract by making a conforming tender of delivery within the agreed time. The seller shall compensate the buyer for all of the buyer's reasonable expenses caused by the seller's breach of contract and subsequent cure.

Where the buyer rejects goods or a tender of delivery under Section 2-601 or 2-612 or except in a consumer contract justifiably revokes acceptance under Section 2-608(a)(2) and the agreed time for performance has expired, a seller that has performed in good faith, upon reasonable notice to the buyer and at the seller's own expense, may cure the breach or contract, if the cure is appropriate and timely under the circumstances, by making a tender of conforming goods. The seller shall compensate the buyer for all the buyer's reasonable expenses caused by the seller's breach of contract and subsequent cure.

U.C.C. § 2-508 (Proposed Official Draft 2000).

3. *July 2000 Draft Section 2-501 Insurable Interest in Goods; Manner of Identification of Goods*

provides that the consumer buyer's rights under Section 2-502 "vest" at the time of identification under Section 2-501. The intent of this vesting provision is to create a prior lien right that is more likely to have priority over the claim of a trustee in bankruptcy. It is debatable whether that vesting would be effective; Section 2-502 has provided no such security in the past, but that issue is beyond the scope of this article.⁴

Existing Section 2-502 is a chimerical right. The requirement that the seller become insolvent only within the ten-day period following receipt of the first installment means that it is a rare case in which the buyer may rely on the section at all. Unfortunately for that rare buyer, bankruptcy frequently follows closely upon the heels of insolvency, and a trustee in bankruptcy has a clear right to avoid any lien created as a result of insolvency of the debtor.⁵ The avoidance of the lien leaves the buyer with only its claim for money damages under Part 7 of Article 2, and the buyer is treated as a general unsecured creditor in the bankruptcy.

This result is consistent with the general principles of buyer's remedies under Part 7 of Article 2 that presume a buyer is adequately protected by money damages. The buyer may cover and claim for the difference in price pursuant to Section 2-712 or if no cover is made, recover based on

The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and the buyer has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs:

when the contract is made if it is for the sale of goods already existing and identified;

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

when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within 12 months after contracting or for the sale of crops to be harvested within 12 months or the next normal harvest season after contracting whichever is longer.

The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in the seller and where identification is by the seller alone the seller may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

This section does not impair any insurable interest recognized under any other statute or rule of law.

U.C.C. § 2-501 (Proposed Official Draft 2000).

4. The Bankruptcy Code grants a trustee in bankruptcy broad powers to avoid unperfected liens and security interests. For example, Section 545 of the Bankruptcy Act permits the trustee to avoid a statutory lien that would be ineffective against a buyer in due course who purchases as of the date of filing of the bankruptcy. See 11 U.S.C. 545 (1994). For some early discussions on the subject, see also *Bankruptcy and Article Two of the Uniform Commercial Code: The Right to Recover the Goods Upon Insolvency*, 79 HARV. L. REV. 598 (1966); Irving A. Gordon, *The Prepaying Buyer: Second Class Citizenship under the Uniform Commercial Code Article 2*, 63 NW. U. L. REV. 565 (1968); Irving A. Gordon, *Unconscionability in Bankruptcy: The Federal Contribution to Commercial Decency*, 66 NW. U. L. REV. 741 (1971).

5. 11 U.S.C. § 545 (1994).

the difference between the contract and market prices at the time the buyer learned of the breach pursuant to Section 2-714.⁶ Specific performance is a rare event. Under present Section 2-716, Buyer's Right to Specific Performance or Replevin,⁷ a buyer can obtain specific performance only for unique goods or in special circumstances. One of the basic tenets of Article 2 is that goods are ordinarily treated as replaceable by reasonably equivalent goods so that the buyer is adequately protected by obtaining goods elsewhere, and the courts are reluctant to become involved in implementing the parties' agreement.

When a seller becomes insolvent or files bankruptcy, monetary remedies become worthless, or nearly worthless. A general unsecured claim in bankruptcy is often unrecoverable in any amount, and at best will return only a few cents on the dollar. For an ordinary buyer (one who does not pre-pay), that loss is regrettable, but is limited to the change in the market between the time of the contract and the breach. That change may be very substantial, but is more often unremarkable.

The commentary and sometimes the courts have struggled with the fairness of the result under current law when the buyer pre-pays. Is the buyer the owner of the goods in the seller's possession and rightfully entitled to the goods, or a trade creditor that has extended credit?⁸ In either event, it is a risk that existing Article 2 leaves with the buyer. (Note, however, that a sophisticated pre-paying buyer may file as a secured creditor under Article 9 of the Uniform Commercial Code and obtain priority rights in the goods.)

In reality, a commercial pre-paying buyer may be either an owner or a true creditor. Defining the statutory priority by a single assumption would be unsatisfactory. For example, a seller may have required progress payments as an ordinary condition of doing business, or based on the buyer's creditworthiness. Alternatively, in the case of a large buyer such as Sears, the buyer may intentionally subsidize the seller's capital cost of financing production in order to lower its own costs.

If the buyer is an owner, it could be argued that the bankrupt estate, or the insolvent seller, is unjustly enriched by retaining both the buyer's prior payments under the contract and the proceeds of the second sale of

6. For a more complete summary of a buyer's remedies, see Roy Ryden Anderson, *An Overview of Buyer's Damage Remedies*, 21 UCC L.J. 28 (1988).

7. *Official Text Section 2-716 Buyer's Right to Specific Performance or Replevin*

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

U.C.C. § 2-716 (1994).

8. See Gordon, *The Prepaying Buyer*, *supra* note 4, at 565.

the goods; while the buyer is left with its loss on the contract as well as the cost of substituted goods. Those proponents would argue that it is entirely fair to both parties to permit the pre-paying buyer to tender the remaining outstanding price, take its goods, and be relieved of further participation in the administration of the insolvent seller's estate.

Others (and this view is firmly established in existing Section 2-502) would argue that a pre-paying buyer is not different than any other trade creditor. This is certainly true in the sense that a trade creditor typically extends short-term credit, and that credit is intended only to facilitate payment, not as capital financing. In fact, a large pre-paying buyer may have significant leverage to negotiate with the seller or trustee if the buyer's continued patronage is necessary for the successful reorganization of the debtor.

Notwithstanding, a case-by-case analysis would be unsatisfactory. Certainty in the law would be compromised, and litigation would be encouraged by such an approach. One cannot fault the drafters for choosing not to modify the section with respect to commercial buyers. Although one might hope for more lenient treatment of less sophisticated or less formalistic commercial pre-paying buyers, the law is well established, the results are predictable, and there are no clear equities that justify changing the rule.

Modification is justified, however, in the case of consumer buyers. The existing structure does not work well for consumers who have an item on lay-away or who have made installment payments on a particular good. Even though comparable goods exist, the consumer may not have the funds to make a second purchase or to pursue litigation. Commercial buyers are often equally frustrated by a non-performing seller, but one cannot make the same assumptions about their ability to cover. In some instances cover is just as difficult for a commercial buyer as a consumer and the economic stress just as devastating, but this is not universal.

A commercial buyer may also pre-pay as a result of its self-interest; a consumer buyer never will. The consumer buyer will pre-pay only as a result of the seller's demand for such payment. A commercial pre-paying buyer may often be fairly classed as a trade creditor, but a consumer never makes a choice to extend credit to the seller.

In the case of an insolvent or bankrupt seller, allowing completion of the consumer transaction is fair to both parties. Each receives the benefit of the original contract. Other creditors of the seller are not disadvantaged because they receive the proceeds of the transaction. The seller may be disadvantaged to the extent of a change in market conditions, but that is its risk in the original contract. It is highly unlikely that such market risk was forced on the seller by the consumer.

The result is also fair to both parties in the case of a solvent seller, although it is of questionable practical benefit. Litigation is rarely a practical alternative in consumer transactions, the cost of prosecuting the action is simply not justified by the size of the problem. But, to the extent

litigation is pursued, it would be simplified rather than complicated by the change. The buyer need only prove it has performed its part of the contract, and need not seek to cover or provide proof of damages or market prices.

A consumer preference in Section 2-502 may be difficult to reconcile with existing case law on purely analytical grounds, but it is a fair result.

The second notable change in the July 2000 Draft is to Section 2-508 Seller's Right to Cure. The drafters again distinguish between consumer and commercial transactions, but in Section 2-508, the change affects only commercial transactions. The July 2000 Draft extends the right to cure for rejected goods to goods for which acceptance is revoked pursuant to Section 2-608(a),⁹ but only to the extent the revocation is based on a latent defect. The seller does not get an additional cure attempt if revocation is based on the seller's failure to provide a promised cure. The seller must give timely notice of its intent to cure and provide a cure which is "appropriate and timely under the circumstances" by making a tender of conforming goods.

In another important change, Section 2-508 now expressly includes language that requires the seller to compensate the buyer for all of its reasonable expenses caused by the seller's breach and subsequent cure. Current Section 2-508 does not contain such language; however, it is established law that cure does not relieve the seller of any damages for which it is otherwise liable. It does not appear that this change to Section 2-508 broadens the seller's liability; it merely clarifies an existing obligation. The buyer, of course, may waive the obligation.

9. This section is not changed from the Official Text except for the addition of (d) and some minor wording changes.

July 2000 Draft Section 2-608, Revocation of Acceptance in Whole or in Part; Use of Goods Following Rightful Rejection or Justifiable Revocation of Acceptance

The buyer may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the buyer if the buyer has accepted it on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or without discovery of such nonconformity if the buyer's acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

Revocation of acceptance must occur 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. It is not effective until the buyer notifies the seller of it.

A buyer that so revokes has the same rights and duties with regard to the goods involved as if the buyer had rejected them.

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

Any use by the buyer that is unreasonable under the circumstances is wrongful as against the seller and is an acceptance only if ratified by the seller.

Any use of the goods that is reasonable under the circumstances is not wrongful as against the seller and is not an acceptance, but in an appropriate case the buyer shall be obligated to the seller for the value of the use to the buyer.

The expansion of cure rights to revocation cases has been the subject of some controversy. Both commercial and consumer interests expressed concern that the expansion would lead to multiple cure efforts, leaving the parties mired in a swamp of uncertain rights. Consumer interests were particularly vocal on the point, contending that consumers with their weaker bargaining positions would be subjected to endless machinations by sellers in the name of cure. Hence the exclusion of consumer transactions from the provision.

This concern is not unfounded, but existing case law is quite clear that sellers do not have an unlimited opportunity to cure. Cures must be timely, must conform to the parties' agreement, and must be reasonable under the circumstances. Courts now deal regularly with this issue in cases involving both rejection issues under Section 2-508 and warranty issues. For example, the courts have addressed this issue in the following cases: *Conte v. Dwan Lincoln-Mercury, Inc.*;¹⁰ *Beal v. General Motors Corp.*;¹¹ *General Motors Acceptance Corp. v. Grady*;¹² *Kure v. Chevrolet Motor Division*;¹³ and *Thurman v. Nomad Travel Trailers*.¹⁴

There is no reason to presume that the expansion of cure proposed by revised Section 2-508 would invalidate existing precedents under Section 2-508. Existing precedents on whether the cure was conforming, the seller's actions timely, notice properly given, or actions taken by the parties were in good faith would all survive. These precedents should provide a firm foundation for evaluation of the seller's cure rights with respect to goods for which acceptance was revoked.

Again, however, there is no fair criticism to be made of the drafters for declining to expand cure rights with respect to consumers. Although distinguishing consumer transactions on purely analytical grounds may be difficult, the July 2000 Draft preserves established law with respect to consumers. Stability is served and no harm is created.

On the other hand, the expansion of cure rights in commercial transactions is a positive change. This is the case for two reasons. First, and most importantly, is that the change reflects actual practice in the marketplace. The change should simplify analysis by courts that often struggle with trying to analyze consensual cure efforts in terms of revocation, warranty and waiver. Often the courts simply cite a number of rationales without clear delineation.¹⁵ The case law simply focuses on the facts of the transaction and the reasonableness of the cure under the circumstances of the case. The respective courts in *T&S Brass & Bronze Works*,

10. 374 A.2d 144 (Conn. 1976).

11. 354 F. Supp. 423 (Del. D.C. 1973).

12. 501 N.E.2d 68 (Ohio Ct. App. 1985).

13. 581 P.2d 603 (Wyo. 1978).

14. 496 P.2d 1348 (Kan. 1972).

15. Several articles have detailed the difficulty of the courts in dealing with cure. William H. Lawrence, *Cure in Contract for the Sale of Goods: Looking Beyond Section 2-508*, 21 UCC L.J. 333 (1989); E. Allan Farnsworth, *The Problems of Nonperformance in Contract*, 17 NEW ENG. L. REV. 2 (1982); Howard Foss, *The Seller's Right to Cure When the Buyer Revokes Acceptance: Erase the Line in the Sand*, 16 S. ILL. U. L.J. 3 (1991).

*Inc. v. Pic-Air, Inc.*¹⁶ and *Ayanru v. General Motors Acceptance Corp.* are examples of this type of prior analysis.¹⁷

In some commercial transactions, such as just-in-time purchase arrangements, time for performance truly is critical. The buyer is not, and should not be, required to compromise on timely performance. The buyer has bargained for that, and is entitled to the benefit of the timely performance. If the buyer wishes to adhere to the contractual time limits and cure cannot be made within the agreed time frames, the cure should not be considered "appropriate and timely" under the circumstances. There is no reason to presume that existing case law dealing with "time is of the essence" agreements would be displaced by the revisions to Section 2-508.

On the other hand, in many instances, time for performance is much less critical, and there is no basis for distinguishing between rejection and revocation of goods. The buyer suffers no harm from the cure effort, and marketplace stability is served by keeping the deal together.

In reality, however, in nearly all cases, including and perhaps particularly in the complex buy/sell arrangements characterizing just-in-time supply contracts, the buyer has no realistic, immediately available alternative source of goods. The buyer and seller have an established account relationship, with established credit, and established quality standards and approvals. The parties have direct electronic links for e-mail, order processing, and electronic payments. There may be significant product lead times or customized product specifications or tooling. Even when multiple sellers exist in relatively close proximity to the buyer, it can easily take weeks or months to unwind an existing purchasing relationship and substitute a new seller. That process is always disruptive and frequently expensive. No sane buyer undertakes it without good cause.

Those marketplace realities typically result in discussions and problem resolution attempts that extend well beyond contractually prescribed times for performance. The same workout effort prevails throughout the buying process, in the case of latent defects as well as readily apparent ones. The business people involved are usually quite explicit about what they view the problem to be and the actions they propose to remedy the situation. But it is a rare case in which the business people speak (or even think) in terms of whether the goods have been rejected, or accepted and acceptance revoked; or a claim is being made under a warranty; or whether and to what extent the parties are waiving or modifying terms of the written agreement, if there even are relevant written terms.

Those are issues that are raised by lawyers, either well into the resolution process when relations between the parties have begun to break down, or perhaps on the eve of filing a complaint. It is this lack of legal niceties in the market process that has led to ambiguity in the case law. The courts cannot apply rigorous legal analysis to the way in which the

16. 790 F.2d 1098 (4th Cir. 1986).

17. 495 N.Y.S.2d 1018 (N.Y. Civ. Ct. 1985).

parties have adhered to their agreement, because the parties pretty much wrote the agreement as they went along trying to resolve a problem. The parties' actions go well beyond any conduct contemplated by their original agreement in both time and scope.

This process is messy, but it is not a defect in the market. It is an effective, low-cost way to resolve the differences between the parties, however frustrating it may be to those lawyers who litigate the few transactions where no resolution can be agreed to between the parties. Overall, the courts deal well with those few cases that are litigated by balancing the various interests and making a judgment based on the overall facts of the case.

The proposed expansion of cure rights in Section 2-508 is completely in line with market realities and should actually simplify litigation. The courts will have less need to struggle with attempts to reconcile the parties' consensual acts with the terms of their written agreements. It reduces the time, and therefore expense, necessary to resolve the predicate question of the basis of the cure and frees the court to evaluate the completeness, reasonableness, and timeliness of the cure effort. The case law is consistently decided on the basis of those determinations, rather than on the right of the seller to cure, so it does not appear that the courts will be subjected to any additional burden as a result of the proposed revision.

The revision also supports market stability by encouraging cooperation between the parties. The buyer has less cause to be concerned that it is waiving or modifying its contractual rights by permitting cure efforts. In every case, the buyer is still entitled to demand payment of its damages incurred as a result of the breach and the cure, so the seller has no economic incentive to drag out the process.

The second reason to adopt expanded cure rights is to maintain party neutrality in the July 2000 Draft of Article 2. Although the changes to the July 2000 Draft are far more moderate than those in the July 1999 Draft, they are still very significant changes. A number of those changes increase the potential for interpretation of the parties' agreement by the courts to include matters beyond the four corners of the written contract. For example, the parol evidence rule in Section 2-202 is liberalized by expressly permitting a court to consider course of performance, course of dealing, and usage of trade when there is no ambiguity in the document. The formation rules in Section 2-204 are more explicit about the inclusion of any aspect of the parties' agreement, whether or not it is contained in the written agreement. The provision is not an expansion of the concepts of present law, but it is an expansion of the language. The changes in the express warranty sections, Section 2-313, Section 2-313A, and Section 2-313B, expand the creation of formal warranty obligations by advertising and other forms of communication. Because these sections govern express warranties, the warranties are difficult and usually impossible to avoid or disclaim. The revisions to Section 2-608 expressly permit a buyer

to make reasonable use of non-conforming goods after rejection or revocation of acceptance.

The changes are far more subtle than those in the July 1999 Draft dealing with these issues. They are not clearly detrimental to the goal of contractual clarity and certainty. All of these changes are based on existing case law, but each is a clear liberalization of the text. Each of these changes is more likely to favor the buyer than the seller. Collectively, they could undermine neutrality between the parties. The proposed expansion of cure rights, also based on existing case law, is one of very few changes that favor the seller, and it counter-balances changes in the text that favor buyers.

Augmented cure rights encourage, even require, the parties to attempt to resolve their differences outside of the courtroom. The other changes to Article 2 will tend to increase the differences in interpretations of their agreement by the parties, and increase the complexity of the disagreements by increasing the claims that can be asserted and the number of relevant facts. Liberalizing required reconciliation efforts necessary to avoid increasing litigation as well.

The final provision to be reviewed in this article is the retention of Section 2-510 Effect of Breach on Risk of Loss. This is a significant change from the July 1999 Draft. The reinstatement of Section 2-510 has been controversial because it is based on a long history of commentary dating back to the inception of the drafting process in 1988. However, this action is another example of the drafters' decision to retain a well-established provision in Article 2 that operates fairly for both parties. In fact, its deletion, although intellectually engaging, would likely have resulted in an unfair and expensive reallocation of risk that does not reflect practices in the marketplace. The history of the retention of Section 2-510 is more extensive than some other changes to Part 5, and there is relevant existing case law to consider, so it warrants a more thorough review.

The genesis of the Article 2 revision process was the appointment in 1988 of a study group by joint action of the Permanent Editorial Board ("PEB") of the UCC, ALI, and NCCUSL (the "PEB Study Group"). The PEB Study Group published a preliminary report in March 1990, which was summarized by an ABA Task Group.¹⁸ The PEB Study Group published its final report in March 1991, recommending that Article 2 be revised.

Sections 2-509 and 2-510, the risk of loss provisions, were cited in particular as sections that should be revised. The PEB Study Group recommended repeal of Section 2-510 saying:

The Study Group recommends that § 2-510 be repealed. Given the tenuous nature of the reallocation policy in § 2-510, the effort required to redraft the statute for clarity in application is not justi-

18. ABA Task Group, *An Appraisal of the March 1, 1999 Preliminary Report of the Uniform Commercial Code Article 2 Study Group*, 16 DEL. J. CORP. L. 981 (1991).

fied. If repeal is rejected, § 2-510 should be revised to insure a link between the breach and casualty to the goods. If the breach is not the substantial cause of the loss, there should be no reallocation of the usual risk of loss outcome.

Section 2-510 reallocates the risk of loss in certain cases where one party is in breach. The assumption is that the risk would have passed under § 2-509 but for the breach. But it is not necessary that the breach have caused the loss and there is no obvious connection between the fact of breach and which party is the least cost insurer of the goods. The effect of § 2-510, therefore, is to reallocate the risk from the party in the best position to insure to the contract breacher who, presumably, is not. This result makes little sense in a commercial statute.

Even if the reallocation were plausible, § 2-510 is complex, incomplete and difficult to apply.¹⁹

The July 1999 Draft adopted the PEB Study Group's recommendation, deleting Section 2-510 and making changes to Section 2-509 both to reflect the deletion of Section 2-510 and to implement additional changes recommended by the PEB Study Group. (The full text of current Section 2-509 and Section 2-510 and the July 1999 revision of Section 2-509, renumbered as Section 2-612 in the July 1999 Draft, are reproduced below.²⁰)

19. *Id.* at 1153.

20. *Official Text Section 2-509. Risk of Loss in the Absence of Breach.*

- (1) Where the contract requires or authorizes the seller to ship the goods by carrier
 - (a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505); but
 - (b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.
- (2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer
 - (a) on his receipt of a negotiable document of title covering the goods; or
 - (b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or
 - (c) after his receipt of a non-negotiable document of title or other written direction to deliver, as provided in subsection (4)(b) of Section 2-503.
- (3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant, otherwise the risk passes to the buyer on tender of delivery.
- (4) The provisions of this Section are subject to contrary agreement of the parties and to the provisions of this Article on sale on approval (Section 2-327) and on effect of breach on risk of loss (Section 2-510).

U.C.C. § 2-509 (1994).

Official Text Section 2-510. Effect of Breach on Risk of Loss.

- (1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

The PEB Study Group position has its foundation in extensive commentary on Section 2-510. This section has been the continuing subject of commentary, beginning upon its adoption and continuing to the present, despite the relatively small number of reported cases and the lack of controversy involving those cases.

Section 2-510 was originally included in Article 2 with very little fanfare. Only subsections (2) and (3) drew comment. Those subsections permit under-insured buyers who rightfully revoke acceptance, and underinsured sellers whose buyer repudiates or otherwise breaches with respect to identified goods before the risk of loss has passed to the buyer, to treat the breaching party as having the risk of loss for a commercially reasonable time to the extent of any deficiency in the innocent party's insurance coverage.²¹

Those sections were noted because rather than transferring the proceeds of insurance coverage to the party with the risk of loss, it shifts the risk of loss to the insured party. This is important because it effectively limits the insurance carrier's ability to subrogate. Because there is no underlying contractual obligation, the carrier is unable to subrogate and

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

July 1999 Draft of Proposed Revision of Existing Section 2-509 Risk of Loss.

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

(b) Except as otherwise provided in subsection (c), risk of loss passes to the buyer regardless of the conformity of the goods to the contract as follows:

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

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

(A) If the contract does not require delivery at a particular destination, the risk of loss passes to the buyer when the goods are delivered to the carrier and the seller complies with Section 2-602 and 2-603, even if the shipment is under reservation.

(B) If the contract required delivery at a particular destination and the goods arrive there in the possession of the carrier, the risk of loss passes to the buyer when the goods are tendered in the manner required by Section 2-602.

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

(A) on the buyer's receipt of a negotiable document of title covering the goods with any required endorsement;

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

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

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

(1) If the buyer rightfully rejects the goods or justifiably revokes acceptance of the goods, the seller has the risk of loss from the time the rejection or revocation is effective.

21. See F. Carlton King, Jr., *Section 2-510; Rule without Reason*, 77 *COM. L.J.* 272 (1972).

cannot transfer the risk back to the contractual party.²²

This approach was consistent with the purposes of adopting, Section 2-510. Under the Uniform Sales Act, title determined risk of loss,²³ as well as a number of other rights and interests in goods. Accepted case law, relying on the English case, *Tarling v. Baxter*,²⁴ transferred constructive title and risk of loss at the time of contracting. This effectively divorced risk of loss from possession or control of the goods. Title is an uneasy concept that is not well defined, and its passage is not easily marked in complex commercial transactions. It is relatively easy to pinpoint title transfers in a simple over-the-counter retail sale, but quite another in the case of specially manufactured goods, goods subject to progress or layaway payments, goods delivered on trial, or goods sold through an agent or distributor. Title to goods may shift progressively as they are loaded onto a truck for shipment.

One of the major innovations in Article 2 of the UCC was to greatly restrict the role of title in determining rights of the parties in the goods. It was an innovation that Karl Llewellyn believed to be of central importance²⁵ and one which has been generally accepted as a positive innovation.

But the commentary since 1938 has gone much more than “a bit beyond” discussions of the implications of title. Defeating title as the prime determinant of risk of loss was clearly a step forward, but it is not the end of the inquiry.

Allocation of risk of loss has several purposes. It provides clarity in commercial transactions and so provides predictability in business planning. It seeks to maximize the benefit of insurance coverage, and to encourage business parties to obtain appropriate coverage. It seeks to promote efficiency in the marketplace by giving the parties greater information about their business risks so that insurance coverage is limited to an efficient level.²⁶

To achieve those purposes requires balancing competing interests and theories of liability. The primary basis for allocation of risk of loss under Section 2-509 is allocation on the basis of possession, or at least control, of the goods. The theory is that the party in control of the goods is in the best position to protect against loss, make claims against carriers, and to obtain appropriate insurance.²⁷

However, the only avenue available under Article 2 to accomplish these purposes and to balance the competing interests, is the assignment

22. *Id.* at 274.

23. See Robert 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).

24. 108 Eng. Rep. 484 (K.B. 1827).

25. See Llewellyn, *supra* note 1.

26. See Note, *Risk of Loss in Commercial Transactions: Efficiency Thrown into the Breach*, 65 VA. L. REV. 557 (1979).

27. See Margaret Howard, *Risk of Loss Under the UCC: Transactional Evaluation of Sections 2-509 and 2-510*, 15 UCC L.J. 334 (1983).

of financial responsibility for a loss. The party on which the risk falls will bear the economic burden of the risk whether or not the party has realistic control and regardless of the existence of insurance coverage. Losses frequently occur while the goods are in the possession of a carrier and outside the physical control of either party. Many businesses do not carry insurance on inventory; and many have a large deductible or self-insurance retainage because of the expense of obtaining first dollar insurance coverage. In those fairly common instances, the party with the risk of loss will pay for the loss as an out-of-pocket, unbudgeted cash outlay. The balance of interests must be achieved by piling up stones of varying weight and size rather than by allocation of carefully calibrated weights.

From a business perspective, clarity of the parties' obligations and the ability to plan is critical. The question of allocation of risk of loss is intensely practical. Rather than phrasing the discussion of the appropriate allocation of risk in terms of maximizing economic efficiencies, the question is probably more properly phrased in Llewellyn's manner:

Has the party who was called to perform, completed enough of its performance to warrant transfer of responsibility to the other party? Must the buyer pay (the price); or if it has been paid, can he get it back? [The seller] agreed to ship goods of a certain description. Well, has he shipped? Or has anything supervened which makes it fair to throw risk on the buyer without shipment?²⁸

When one thinks of allocation of risk of loss in terms of allocation of the responsibility for the payment for the price of goods which have either been destroyed or been diminished in value, the path through the complexities of proper balancing of the parties' interests and responsibilities becomes clearer.

Indeed, the case law under Section 2-510 is entirely commonplace and nearly all of it arises under subsection (1). The majority of the cases are ten pages or less in length, and the conclusions are consistent between jurisdictions, across fact patterns and over time; although there are a few anomalous cases in which the court did not follow the letter of the rule. The case law is so mundane that few commentators trouble to review the cases. However, laws have to be judged on the effect they have; whether the purposes of the law and underlying values have been served in practice. A review of the case law is actually critical to an understanding of the implications of changes in Article 2 allocations of risk.

One line of cases, headed by *William E. Wilke, Inc. v. Cummins Diesel Engines, Inc.*,²⁹ holds that the seller is responsible for completing tender of the goods themselves and other agreed services such as installation and set-up, before risk will pass. In *Cummins*, Wilke, a mechanical contractor, purchased a diesel generator. Cummins delivered it to the job site several months before it was needed for operation. It was installed on a permanent base designed for it, but no batteries or maintenance or oper-

28. Llewellyn, *supra* note 1, at 184.

29. 250 A.2d 886 (Md. 1969).

ating instructions were included. The Cummins representative made the statement "This is my baby until I start it and turn it over."³⁰ Wilke paid the entire invoice except a \$200 retainage. The generator was damaged from exposure to winter weather, failed on startup, and had to be repaired. The court held that the risk of loss remained on Cummins. Cummins's behavior did not amount to a delivery of goods or the performance of obligations conforming to the contract. It could not constitute such a delivery and performance until the generator had been installed, started up and field tests completed to the satisfaction of the buyer. Until then, the risk of loss remained with Cummins regardless of where title may have been.³¹

Courts have consistently followed this precedent, as is shown by the recent case of *In re Thomas*.³² In this case, the plaintiff contracted for the purchase and installation of a pool heater. The heater was delivered, but left in a driveway. The length of time it remained in the driveway and the content of the parties' conversations were factual disputes, but it was undisputed that the heater disappeared from the driveway. The court held that installation was a required term of the seller's performance. It had not installed the equipment, so risk remained on the seller.

In *Southland Mobile Home Corp. v. Chyrchel*,³³ Mrs. Chyrchel purchased a trailer for her mother. The seller agreed to install a new gas stove, move, and set up the trailer. The trailer was moved, the gas stove installed, but not all of the hook-ups were completed. Mrs. Chyrchel complained of a gas smell, was told not to worry, and the trailer was left over the weekend. Mrs. Chyrchel left the windows open to air the trailer, but came back Sunday to shut them because of the threat of rain. Several hours later the trailer exploded and burned from a gas leak. The risk of loss was held to be on the seller because its services were incomplete. A noteworthy fact of this case is that Southland was held responsible even though it did not, in fact, own the trailer. Its employee, acting on his own behalf, sold the trailer to Mrs. Chyrchel when Southland did not have one available. The employee did not disclose that he was not acting on behalf of Southland, and had actually sold two additional trailers to Mrs. Chyrchel for Southland in the same transaction. The court held that the employee had apparent authority to bind Southland.

Other cases illustrate the general rule of Section 2-510(1). An illustrative commercial case is *United AirLines, Inc. v. Conductron Corp.*³⁴ In 1969, United AirLines ("United") purchased a flight simulator from Conductron. The simulator was delivered and set up for testing. United had noted more than 600 deficiencies, and the simulator was never operational during the six weeks it remained in United's possession. The simu-

30. *Id.* at 888.

31. *Id.*

32. 182 B.R. 347 (Bankr. S.D. Fla. 1995).

33. 500 S.W.2d 778, 779 (Ark. 1973).

34. 387 N.E.2d 1272 (Ill. App. Ct. 1979).

lator caught fire and burned in April 1969 following a ten-hour test. After extended discussions between the parties an action for rescission was brought in May 1973. It was not until 1977 that a count was added to the complaint saying the risk of loss remained on the seller because the goods were non-conforming. United then moved for summary judgment based on that count, and prevailed. The court rejected Conductron's argument that United had accepted the simulator by failing to reject the simulator during the six-week period. The court cited the parties' agreement, which called for acceptance testing, and noted that using a product for the purpose of acceptance testing cannot be used as a basis for finding acceptance.

*TJ Stevenson & Co., Inc. v. 81,193 Bags of Flour*³⁵ applied Section 2-510 in a relatively complex factual situation. Bolivia purchased flour from ADM. Plaintiff Stevenson was the unlucky carrier for the overseas portion of the shipment. Because of labor disputes at several ADM plants, ADM supplied the flour from three of its own plants, and four subvendors. Although there was a long dispute over the matter, it was finally determined that some or all of the subvendors sold flour which was contaminated with flour weevils, or the flour was contaminated at the rail cars before risk passed to the buyer. During the extended shipment process, which included three separate rail shipments, an extended stay in a Mobile warehouse and three ocean shipments, the flour weevils flourished. The first two shipments were tested in Mobile after being loaded off of the rail car. The testing report was delayed and the ships partially loaded before the report was received, showing substantial infestation. The ships and the remaining unloaded flour were fumigated, clean bills of lading issued, and the flour was shipped. But, upon arrival in Chile, still en route to Bolivia, extensive live infestation was found. Chile refused to allow the cargo to be discharged. Bolivia rejected it, and ADM disclaimed liability, saying it had shipped conforming flour. The third shipment was rejected by Bolivia in New Orleans, and testing confirmed infestation of the third shipment. Stevenson, the shipper, was left with flour no one wanted. The flour was eventually disposed of at a discounted price, either to consumers after reprocessing, or for industrial use, with all parties reserving their rights.

Stevenson filed the action in order to obtain some resolution of the situation. The court held the risk rested on ADM completely for the last shipment, which was non-conforming and was rejected out of hand. For the first two shipments, the court held the shipments were non-conforming, but were accepted upon the reprocessing and acceptance in Chile. Applying Section 2-509 and Section 2-510, ADM was held responsible until that point. The reprocessing and discounted resale was treated as a warranty issue, but risk passed at the point of acceptance, even though the goods were non-conforming.

35. 629 F.2d 338 (5th Cir. 1980).

*Design Data Corp. v. Maryland Cas. Co.*³⁶ is a rare example of a case under Section 2-510(2), allowing a buyer that revokes acceptance to treat the loss as on the seller. Design Data sold a drafting plotter to HHB that was damaged during shipment. A representative of Design Data was on site at the buyer's place of business for arrival of the goods. There was damage to the carton, the plotter was removed, hooked up, tested, and failed to function. The court held the buyer had accepted the goods, but revoked its acceptance in a timely manner. Design Data filed a claim against the carrier, but its recovery was limited by tariff. Design Data then filed a claim against its insurer, Maryland. Maryland denied the claim saying Design Data no longer owned the equipment, and no longer had an insurable interest. The court disagreed, holding the revocation was effective, and pursuant to Section 2-510(2), the risk was on Design Data.

The leading case under Section 2-510(3), permitting a seller to treat the risk of loss for conforming, identified goods, as on a breaching buyer for a commercially reasonable time, is *Multiplastics, Inc. v. Arch Industries, Inc.*³⁷ In that case, the buyer contracted for specifically manufactured plastic pellets and agreed to accept 1000 pounds per day, but failed to issue any releases. After forty days, the seller warehoused the pellets and demanded that the buyer begin accepting pellets. The buyer agreed to do so, but never issued releases. Five weeks later, the seller's warehouse burned, destroying the pellets, and the uninsured seller sued for the price. The court agreed that the risk was on the buyer and held that the five-week period was commercially reasonable.

*Portal Galleries, Inc. v. Tomar Products, Inc.*³⁸ is a Section 2-510(3) case in which the seller did not fare as well. Portal Galleries had sold a number of paintings to Tomar. Tomar repudiated the contract in October, refusing to accept ordered paintings. The seller did not pursue the buyer; instead he resold 150 paintings to a third party without giving notice to the buyer and attempted other avenues of resale. In January, however, a fire in the warehouse destroyed the remaining paintings. Portal sought recovery from Tomar. The court held that the seller had abandoned the contract, and that the four-month period between the repudiation and the loss was not a commercially reasonable time to treat the buyer as responsible under the circumstances of the case.

Other cases hold, fairly consistently, that a seller who has possession of rightfully rejected goods in order to cure the defect has the risk of loss until re-delivery. See *McKnight v. Bellamy*³⁹ in which a mare, sold as in foal was returned to the seller for re-breeding and died while in the seller's possession; and *Jakowski v. Carole Chevrolet, Inc.*⁴⁰ in which a car

36. 503 N.W.2d 552, 555 (Neb. 1993).

37. 348 A.2d 618, 622 (Conn. 1974).

38. 302 N.Y.S.2d 871 (NY Sup. Ct. 1969).

39. 449 S.W.2d 706, 707 (Ark. 1970).

40. 433 A.2d 841, 842 (N.J. Super. Ct. Law. Div. 1981).

sold without a required undercoating or polymer finish was returned to the dealer for cure and was stolen while in the seller's possession. It made no difference that the non-conformity was relatively minor.

Only a few cases present any interesting anomalies. One estoppel case is interesting and demonstrates one of the few instances when a court deviated from the provisions of Section 2-510.

In *Mercanti v. Persson*⁴¹ the buyer special ordered a mast to be built for his boat. The buyer was to supply hardware and the cost of materials. The contract was made in July 1963. The seller had completed the woodwork by December 1963, but the buyer did not supply the hardware until June 15, 1964. On June 17, the boatyard burned, along with the mast. The seller claimed the risk was on the buyer, pursuant to Section 2-510(3), citing the buyer's lengthy delay as a breach of the agreement. The court held that because there was no date in the contract for the buyer's performance, he was not in breach. However, the court found in favor of the seller based on its finding that the buyer had represented that it had insurance and was estopped from claiming damages.

Two of the leading cases under Section 2-510, *La Casse v. Blaustein*,⁴² and *Baumgold Bros. Inc. v. Allan M. Fox, Co., East*,⁴³ present one of the few inconsistencies in the cases.

In *La Casse*,⁴⁴ the buyer, an MIT student helping to finance his way through school by selling calculators, purchased calculators from the seller. He sent a blank check with authorization to spend up to fifty dollars for shipment of the calculators along with his payment for the calculators. United Parcel Service ("UPS") was the seller's usual carrier. The seller was initially reluctant to sell to the buyer because UPS was on strike, but eventually agreed to do so on a pre-paid basis. The seller shipped by the U.S. Postal Service. One of the cartons disappeared in transit. The court held that the contract was a shipment contract over the buyer's argument that the contract should have been classified as a destination contract because the language used required "delivery to the buyer's address with the shipping method at the seller's discretion."⁴⁵ The court then found in the buyer's favor because the seller had breached its duty to make a proper contract.⁴⁶ The seller had failed to insure the calculators, had affixed side labels clearly disclosing the contents, and had misaddressed one of the boxes. The court held that the seller's actions in preparing the shipment had contributed to the theft and that its failure to insure the shipment, even though the buyer had made adequate funds available, was negligent.⁴⁷

41. 280 A.2d 137, 139 (Conn. 1971).

42. 403 N.Y.S.2d 440 (N.Y. Civ. Ct. 1978).

43. 375 F. Supp. 807 (N.D. Ohio 1973).

44. *Le Casse*, 403 N.Y.S.2d at 442.

45. *Id.*

46. *Id.*

47. *Id.*

The *Baumgold* case⁴⁸ came to a similar result by a different route. Baumgold Bros. were diamond dealers who sent a package of diamonds to the buyer, Fox Co., a jewelry store. Fox issued a purchase order for the diamonds, but the parties agreed the diamonds were shipped on a “memorandum” basis against partial payment and would be returned if not sold. They had done this on at least one occasion in the past and Baumgold Bros. included its standard “shipping memorandum” with the package that disclaimed all liability for the shipment. The shipment, in accordance with Baumgold’s custom, was by registered delivery U.S. Postal Service. A substitute mail carrier left the mail, including the diamonds, on a counter without getting a receipt. When a customer mentioned to a Fox employee that the mail had come, the diamonds were missing. The regular mail carrier obtained a receipt several days later, by representing to an employee that a package had been received. The Fox manager later objected vehemently, stating that the store did not have the package. The court allowed the shipping memorandum as part of the contract, after discussion of the application of Section 2-207, the battle of the forms; Section 2-201 on offer and acceptance; course of dealing and the statute of frauds. The court determined that the words in the shipping memorandum “the merchandise is delivered to you on memorandum only, at your risk from all hazards . . . upon the express condition that all such merchandise shall be returned on demand, in full, in its original form”⁴⁹ was ambiguous. It held the words “the merchandise is delivered to you . . .” indicated a destination contract and that was further substantiated by the seller’s shipment by registered mail with insurance in its favor.⁵⁰

The general rule is that a contract is a shipment contract unless the parties specifically agree that it is a destination contract. The Northern District of Ohio’s willingness to find a destination contract is a little unusual. Since it was a destination contract, and the package was not properly delivered in conformance with the contract, risk remained on the seller. The court noted the seller still had a remedy against the carrier and the decision seems to rest most strongly on giving the risk to the party with insurance, perhaps stretching the concept of breach to reach that result. This result is a little unusual under Section 2-510, but is entirely consistent with the underlying principles of Sections 2-509 and 2-510.

There are more cases applying Section 2-510, but as the sampling above demonstrates, none are remarkable, and none offend the sensibilities as being an inappropriate allocation of the risk. As the *Jakowski* court stated: “It is possible to conjure up a host of hypotheticals leading to seemingly perverse results under Section 2-510. The subject has been the subject of some scholarly criticism The fact is, however, that those

48. 375 F. Supp. 807 (N.D. Ohio 1973).

49. *Id.* at 814.

50. *Id.* at 815.

courts considering it have had little difficulty in applying it as written.”⁵¹

That may, perhaps, be the result of a too simplistic approach. Margaret Howard in her often-quoted article, *Risk of Loss Under the UCC: Transactional Evaluation of UCC Sections 2-509 and 2-510*, concluded:

The normative premises underlying the Code’s risk of loss sections appear straightforward. The Code’s results in some cases, however, cannot be easily reconciled with the premises. An understanding of their complexity may permit more principled resolution of risk of loss issues. The apparent simplicity of the premises on the surface has, perhaps, contributed to the failure of courts and commentators to look below the surface.⁵²

However, it is at least equally likely that Llewellyn had it right the first time, and the basis of Section 2-510 is one of fundamental fairness.

The ABA Task Group, in a footnote to its discussion of the PEB’s recommendations notes:

There is something appealing about the notion that a contract breacher – the party at fault – cannot pass the risk of loss to the innocent party, particularly where that party is not in fact insured and the buyer could have rejected the goods in any event.⁵³

Or to paraphrase Llewellyn’s question: Has the seller done enough that he should be paid?⁵⁴ Answering that question does require balancing the effects of insurance and control with breach, but that does not mean that the question of breach should be irrelevant. There is something fundamentally unfair, and on a more practical note, something inconsistent with commercial realities about requiring a buyer to pay for damaged goods that it did not want in the first place.

Although the July 1999 Draft change deleting Section 2-510 purported to be a neutral change based on putting the risk of loss on the party in the best position to insure and protect the goods, the change actually gave preference to buyers because the seller was not provided with remedies that corresponded to the allocation of risk of loss. Note that both parties have an insurable property interest in the goods from the time of identification to the contract under the Section 2-401 “Insurable Interest”⁵⁵ (Sec-

51. *Jakowski*, 433 A.2d at 843.

52. Howard, *supra* note 27, at 372.

53. See ABA Task Group, *supra* note 18.

54. See Llewellyn, *supra* note 1, at 1153.

55. *Official Text Section 2-401 Passing of Title; Reservation for Security; Limited Application of This Section*.

Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this Article and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (Section 2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation

tion 2-410 is unchanged in the July 2000 Draft, and was not affected for these purposes by the July 1999 Draft revisions). However, the parties have equal rights only so long as the seller has title or a security interest in the goods. (For the sake of clarity, the relevant Official Uniform Code provisions are reproduced below in the notes.) The seller's insurable interest continues only until title passes, which is generally the point at which the buyer receives possession or control under Section 2-401. Title, and an insurable interest, reverts in the seller when goods are rejected or acceptance revoked, whether or not rightful. The buyer's insurable interest does not depend on conformity of the goods, possession or title to the goods.

The end result of the interaction of Sections 2-401, 2-501, and 2-509, as proposed for revision in the July 1999 Draft was that the buyer had an insurable interest in the goods, conforming or not, from the time they were identified to the contract, until the time the seller regained possession of goods which were rightfully rejected or for which acceptance was justifiably revoked, and for some time beyond that point for wrongfully rejected goods.

Under Section 2-401, the seller has an insurable interest only when the seller has title or some other contractual obligation or interest; so, under the July 1999 revisions, would not have had an insurable interest in non-conforming goods which were in the buyer's possession, but had not been rejected. The buyer actually had a more extensive insurable interest in identified goods than the seller, but under the July 1999 Draft revision of Section 2-509 the seller had greater exposure. This anomaly continued in

of a security interest. Subject to these provisions and to the provisions of the Article on Secured Transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading.

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

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

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or

(b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance reverts title to the goods in the seller. Such reversion occurs by operation of law and is not a "sale."

U.C.C. § 2-401 (1994); *see also id.* § 2-205 (for ease of reference, quoted in note 2).

the interaction of the remedy provisions proposed in the July 1999 Draft, but it would serve no purpose to review those provisions.

As an example of the difficulties created by the deletion of Section 2-510, consider the case of non-conforming goods destroyed while in the buyer's possession, but not rejected. One would assume that the buyer's failure to reject and return the goods would result in its acceptance and liability for the price, perhaps with an offset pursuant to Section 2-714 Breach with Respect to Accepted Goods. However, that result was not clearly contemplated by the July 1999 Draft, and with good reason. It would be a rare buyer who would pay for non-conforming and unusable goods and, in addition, absorb any loss created by a gap in its insurance coverage. Those who did so would pay only after long and loud protest, with substantial damage to the parties' business relationship.

In addition, the proposed deletion of Section 2-510 would have nullified several of the leading precedents in the case law, such as *Cummins*,⁵⁶ and *Design Data*⁵⁷ and *In re Thomas*.⁵⁸ Under the proposed revision, the risk would pass to the buyer in each case. All three results depended on the seller's breach with respect to the goods, but either the breach did not cause the loss, or in the *Design Data* case, the buyer accepted the damaged goods. The buyer's ability to relate the allocation of risk back to the seller after revocation of acceptance was eliminated in the July 1999 revision. The risk of loss reverted only as of the time of revocation. Shifting the risk to the buyer would seem to be the less appealing alternative in each of the cases.

The result might also change in the *Chyrchel*⁵⁹ and *United Air Lines*⁶⁰ cases, depending on a court's further determination of the cause of the loss. In both cases, responsibility for the occurrence causing the loss was a disputed issue, but not dispositive under current law. The July 1999 revision left risk of loss on the seller when the non-conformance caused the loss. Consequently, the July 1999 revision would have required the courts in these cases to make an additional examination of the cause of the loss in order to assign responsibility. As a practical matter, it is frequently difficult, time consuming and expensive to determine the cause of an event when the event, such as a fire, has destroyed most of the evidence. This is one of the burdens of tort law, and there is no benefit to be gained by incorporating it into contract law.

In the other cases cited above, the results would have been unchanged under the July 1999 revision formula. In those cases the breach was the cause of the loss, or the loss occurred after rejection, or estoppel would change the result of the provision.

56. 250 A.2d 886.

57. 503 N.W.2d 552.

58. 182 B.R. 347.

59. 500 S.W.2d 778.

60. 387 N.E.2d 1272.

The anomaly created by the July 1999 Draft was less important for its substance, than as an illustration of the emotional impact of the change created by the proposed deletion of Section 2-510. No matter the intellectual appeal of a no-fault transfer of risk of loss, requiring a buyer to pay for goods it cannot use and did not order is not an appealing result. It is also not consistent with commercial practices. Few sellers would insist on payment by the buyer under those circumstances. Fewer still have the market power to actually obtain the payment; and no seller could do so without harm to its business reputation. The return to existing law was a good choice.

Overall, Part 5 of the July 2000 Draft of Article 2 is a balanced, measured adaptation of existing Article 2 to the changes that have occurred in the marketplace over the last 60 or so years since its original enactment. Much of existing Part 5 remains. The changes are clearly identified, are evolutionary in scope, are largely based in existing case law, and are fair to both parties. The July 2000 Draft revision of Part 5 still contains some very significant and controversial changes, but it fairly reflects current commercial practices.

