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# Commercial Codification as Negotiation

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# ARTICLES

## Commercial Codification as Negotiation

*Peter A. Alces\* and David Frisch\*\**

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## INTRODUCTION

Commentators have focused attention on the Uniform Commercial Code ("UCC") revision process of late,<sup>1</sup> and have reached divergent conclusions regarding the efficacy of the status quo<sup>2</sup> as well as the prospects for real improvement in the future.<sup>3</sup> In past articles we identified some deficiencies in the process<sup>4</sup> and have offered specific suggestions for improvement.<sup>5</sup> That debate, and our contribution to it, will not be repeated here.

The focus of this inquiry, instead, is on the method of the drafters of the revision of article 2, what they have chosen to do, and what they have neglected to do. These may not merely be prob-

<sup>1</sup> See, e.g., Peter A. Alces & David Frisch, *On the U.C.C. Revision Process: A Reply to Dean Scott*, 37 WM. & MARY L. REV. 1217, 1218 (1996) (responding to Dean Scott's criticism of UCC law revision process); Corrine Cooper, *The Madonnas Play Tug of War with the Whores or Who Is Saving the U.C.C.?*, 26 LOY. L.A. L. REV. 563, 564-66 (1993) (noting influence of special interest group representatives in commercial law reform process); Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83, 155-62 (1993) (advocating revision of uniform law process in order to curb special interest politics); Donald J. Rapson, *Who is Looking Out for the Public Interest? Thoughts About the U.C.C. Revision Process in Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249, 250-55 (1994) (evaluating criticism of UCC revision process); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising U.C.C. Articles 3 and 4*, 26 LOY. L.A. L. REV. 743, 759-73 (1993) (criticizing commercial law drafting and reasoning process); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595, 600-04 (1995) (analyzing American Law Institute and National Conference of Commissioners on Uniform State Laws and their function as private law-making groups); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1803-06 (1994) (discussing commercial law revision process of UCC article 9); Harry C. Sigman, *Improving the U.C.C. Revision Process: Two Specific Proposals*, 28 LOY. L.A. L. REV. 325, 326-32 (1994) (proposing "public comment" period following approval of revised article).

<sup>2</sup> Compare Alces & Frisch, *supra* note 1, at 1218 (noting trend "toward greater balance in the commercial law than has ever before been realized"), with Scott, *supra* note 1, at 1786-88 (recognizing that although secured creditors have been enthusiastic about article 9, debate as to whether legal regulation of secured financing fosters efficiency is inconclusive), and Patchel, *supra* note 1, at 85-86 (noting increased concern that articles 3 and 4 of UCC inadequately protect consumer interests).

<sup>3</sup> See Alces & Frisch, *supra* note 1, at 1245-46 (discussing problems with amending article 9's filing system); Scott, *supra* note 1, at 1816-22 (commenting on risks associated with special interest group involvement in revision of article 9); Patchel, *supra* note 1, at 155-62 (suggesting ways in which UCC redrafting process can be altered to create structure more favorable to groups that have been inadequately represented in creation of existing law).

<sup>4</sup> See Peter A. Alces & David Frisch, *Commenting on "Purpose" in the Uniform Commercial Code*, 58 OHIO ST. L.J. 419, 447-52 (1997) (describing deficiencies, including deference accorded to uniform law reporter, in formulation of official comments to UCC).

<sup>5</sup> See *id.* at 452 (suggesting that careful, systematic perusal of both black letter and official commentary prior to introduction of uniform law into state legislature establishes independent review on uniform law reporter's official comments).

lems of process; they may be more profound. But we choose to approach them as problems of process and suggest how adjustment of the drafters' method might produce a commercial law more considerate of fundamental commercial contracting principles and, therefore, more responsive to the needs of the commercial community.

Our conclusions and recommendations are the product of our appreciation that, first, any revision of an article of the UCC must appreciate commercial law context — the relationship among the complementary common law and statutory regimes, the fit with evolving commercial law principle, and the other articles of the UCC; second, the revision of article 2 is proceeding as a negotiation between parties with conflicting understandings of the tensions between commercial actors in ways that did not determine the promulgation of original article 2 (at least not to the same extent); third, empirical research has not generally provided a foundation for an adjustment to the status quo.

Part I of this Article endeavors to put the sales law in perspective by emphasizing its role in the broader system of commercial law. Then, in Part II we focus on a particular example (the buyer's right to recover goods upon the seller's insolvency) to support our general observation that the revision reflects a fatal insensitivity to the need for article 2 to fit with other bodies of commercial codification. Part III demonstrates the revision's failure to come to terms with the role of context and makes the argument that the drafters' shortsightedness is evidenced by the manner in which the drafters treat the symbiotic relationship between warranty and products liability law. In Part IV we make the case for care in data collection as a predicate to drafting. Finally, we conclude that the article 2 revision project may not, as currently realized, be worth the commercial law candle.

## I. THE UCC AS PART OF A COMMERCIAL LAW SYSTEM

A central aim of Karl Llewellyn and his fellow drafters of the UCC ("Code") was to provide judges with an institutionalized process of interpretation that emphasized the Code's purposes and policies, and the underlying objectives of individual sections.<sup>6</sup> This

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<sup>6</sup> See Julian B. McDonnell, *Purposive Interpretation of the Uniform Commercial Code: Some Implications for Jurisprudence*, 126 U. PA. L. REV. 795, 797-98 (1978) (discussing Llewellyn's approach to codification and its origins in American legal realism). The natural starting

purposive approach to statutory interpretation is based on the idea that cases of statutory ambiguity are frequent, and that the resolution of the ambiguity calls for an inquiry into something other than the plain language of the text. Because of statutory ambiguity, outcomes must turn on the purpose behind the statute; there is simply no other way to decide hard cases. The point goes deeper still. Whether there is ambiguity is a function not simply of text, but of text as it interacts with purpose. Cases are easy only when the underlying purposes are not in dispute. There are no easy cases without a clearly defined purpose, which is necessary to give context, and hence meaning, to language. Llewellyn put it this way:

The rationale of this is that construction and application are intellectually impossible except with reference to some reason and theory of purpose and organization. Borderline, doubtful, or un contemplated cases are inevitable. Reasonably uniform interpretation by judges of different schooling, learning and skill is tremendously furthered if the reason which guides application of the same language is the same reason in all cases. A patent reason, moreover, tremendously decreases the leeway open to the skillful advocate for persuasive distortion or misapplication of the language; it requires that any contention, to be successfully persuasive, must make some kind of sense in terms of the

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point for understanding the structure and philosophy of the Code is the jurisprudential theories of Karl Llewellyn as discussed in Eugene Mooney's article:

Although much of the actual drafting of the various articles was done by committees, Llewellyn was the coordinator and, as such, exercised both tremendous influence and practical control over the whole project. He and Professor Corbin served on the committee drafting the sales article and in great measure Llewellyn wrote that section of the Code to suit himself. The first version was published in 1949 and although there have been numerous and extensive revisions since then, the sales article and the all-important introductory article (article 1) retain most of the characteristics built into them by Llewellyn.

Eugene F. Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 VILL. L. REV. 213, 223 (1966). Llewellyn was one of the most influential figures in the realist assault on the conceptualism of the old order. See generally WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* (1973) (providing interpretation of Llewellyn's thought and development).

Central to the realist movement was a belief in the *necessity* for a "purposive interpretation" of legal institutions. The theory of purposive interpretation is rooted in the concept of law as a means to selected social ends — a method of social engineering. It seeks to define legal standards in terms of the purposes they are designed to implement. It denies that either statutory provisions or common law doctrines can be adequately understood by reference to a standard of ordinary or plain usage. See *id.*

reason; it provides a real stimulus toward, though not an assurance of, corrective growth rather than straitjacketing of the Code by way of caselaw.<sup>7</sup>

Most conceptions of purposive interpretation emphasize a necessary balance between the Code's purposes and policies, which are designed to promote the Code as a whole, and the purposes and policies of the individual sections under consideration.<sup>8</sup> To require a judge to give due deference to the purposes and policies of the Code as a whole does not necessitate that the judge ignore the rationale of the particular sections that will actually decide the case. To the contrary, the underlying reasons, purposes, and policies of each section take a prominent place in a judge's interpretative enterprise.<sup>9</sup> This balance is reflected in the Code itself.

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<sup>7</sup> Karl Llewellyn, Collection of Karl Llewellyn Papers, J, VI, I, e at 5 (1944) (unpublished manuscript, on file at University of Chicago Law School), quoted in TWINING, *supra* note 6, at 322.

<sup>8</sup> See, e.g., DONALD B. KING, THE NEW CONCEPTUALISM OF THE UNIFORM COMMERCIAL CODE 12 (1968) (stating that policy considerations should also apply on individualized basis rather than being limited only to broad underlying purposes of Code); Steve H. Nickles, *Rethinking Some U.C.C. Article 9 Problems — Subrogation; Equitable Liens; Actual Knowledge; Waiver of Security Interests; Secured Party Liability for Conversion Under Part 5*, 34 ARK. L. REV. 1, 7 (1980) (noting that purposes and policies underlying section 1-102 "are designed to promote the Code as a 'code', i.e., a particular form of statutory law") (citation omitted). When interpreting the Code, due emphasis should also be placed on the purposes and policies underlying the particular rules and principles of Code sections potentially relevant to the decision of a case. See *id.*

<sup>9</sup> This application of purpose and policy is not always easy. See generally Alces & Frisch, *supra* note 4 (noting there are several potential sources of purpose and one can be skeptical about ability of each to articulate and express underlying objectives of particular Code sections). For example, we have argued that even the UCC comments cannot necessarily be relied upon to provide accurate insight into drafters' beliefs about the objectives of the various provisions of the Act. See *id.* at 447-52; see also *infra* notes 14-16 and accompanying text (discussing practical problems one encounters when relying on purpose as interpretive methodology).

Notwithstanding the difficulties inherent in a purposive approach to language and meaning, we believe that adherence to this approach yields systematic benefits that do not necessarily follow from other theories of statutory interpretation. Among these benefits is uniformity of construction. In this regard, consider the introductory comment to the Code, which provides in pertinent part that:

[u]niformity throughout American jurisdictions is one of the main objectives of this Code; and that objective cannot be obtained without substantial uniformity of construction. To aid in uniform construction of this Comment and those which follow the text of each section set forth the purpose of various provisions of this Act to promote uniformity, to aid in viewing the Act as an integrated whole, and to safeguard against misconstruction.

The importance of Code purposes and policies in textual interpretation is the subject of the very first section following the official title of the Code. Section 1-102 states:

- (1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.
- (2) Underlying purposes and policies of this Act are:
  - (a) to simplify, clarify and modernize the law governing commercial transactions;
  - (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
  - (c) to make uniform the law among the various jurisdictions.<sup>10</sup>

The influence (if any) of section 1-102 in textual interpretation is not a settled issue, however.<sup>11</sup> Perhaps the most fundamental criticism of the application of these values is that they do not always lead to uniform results because courts often disagree over which policy is paramount.<sup>12</sup> We do not attempt to order these policies, although we recognize that in particular cases their comparative importance could be crucial in making substantive decisions. For example, section 1-102 creates a potential for tension between substantive choices that promote uniform results and those that permit a court to achieve a more perfect outcome by a liberal con-

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*Law Institute to U.C.C. 1 U.L.A.* at xv (2d ed. 1989).

<sup>10</sup> U.C.C. § 1-102(1)-(2) (1998); *see also* Alces & Frisch, *supra* note 4, at 421-25 (giving historical overview of these subsections).

<sup>11</sup> *See* Alces & Frisch, *supra* note 4, at 428-29 (noting that one could take view that even though Code policies were drawn upon, court was guided primarily by other concerns).

<sup>12</sup> Also, frequently there will be arguments about how the policies should be applied. As one commentator has recognized:

[S]tating that the Code is to be interpreted to further objectives does not in itself provide a precise standard for the determination of the outcome of a particular controversy. Otherwise stated, the mandate to interpret the Code so as to further its objectives does not furnish any real guide to construction because the purposes are of "an essentially neutral nature" and "a great deal will depend upon the vantage point of the one contemplating the problem.

RONALD A. ANDERSON, *UNIFORM COMMERCIAL CODE* § 1-102:41, at 51 (3d ed. 1981). Nonetheless, we believe that the objectives are at least useful in beginning the discussion about substantive decisions.



struction of statutory language.<sup>13</sup> Notwithstanding the fact that the objectives articulated in section 1-102 tend toward vacuity and self-contradiction, the message is clear: the Code should be construed on a policy basis rather than on the basis of mechanical application of ordinary rules of language.

Given the difficulties with section 1-102, it is not surprising that the drafters reasoned that purposive interpretation demands the judge adopt a posture of deference to the policy of a particular section.<sup>14</sup> Presumably, the drafters considered policy issues such as simplification, clarification, modernization, expansion, and uniformity when drafting each section and formed their intentions regarding its meaning.<sup>15</sup> Furthermore, the deferential judicial posture demanded by purposive interpretation requires that the drafters provide the judge with a guide to uncovering the reason(s) for the decisions that were made. In sum, the drafters must abide by

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<sup>13</sup> Compare *In re Broward Auto Brokers, Inc.*, 11 U.C.C. Rep. Serv. 402, 404 (Bankr. S.D. Fla. 1972) (stating that if particular courts or jurisdictions waive one or more specific requirements of UCC in order to liberally construe act, complete lack of uniformity would probably result) with *AMF, Inc. v. McDonald's Corp.*, 536 F.2d 1167, 1170-71 (7th Cir. 1976) (providing that liberal construction of section 2-609 should dispense with need for written demand for adequate assurance of performance). See generally McDonnell, *supra* note 6, at 852. McDonnell states:

A court faced with the problem of the financing statement as a security agreement today would have to contend with the policy of simplification in section 1-102(2)(a), which supports the recognition of a financing statement as security agreement, and the policy of uniformity in section 1-102(2)(c), which, in light of the case law, supports the contrary result. Moreover, how is the jurist to assess which alternative will modernize the law governing commercial transactions in accordance with section 1-102(2)(a)?

*Id.*

<sup>14</sup> See KING, *supra* note 8, at 8 (discussing use of policy considerations by courts). King states:

Policy considerations are not to be limited only to the broad underlying purposes and goals of the Code, but are also to be considered on a more individualized basis. When a court is confronted with an interpretation of a given Code provision or section, it should look to the underlying purpose and policy of that particular section in order to give it meaning. The drafters were clear in their intentions on this point.

*Id.* at 12.

<sup>15</sup> See, e.g., *In re Wolfe*, 9 U.C.C. Rep. Serv. 177, 180 (Bankr. W.D. Mich. 1971) (applying literal reading to Code language in section 9-103); *In re Carlstrom*, 3 U.C.C. Rep. Serv. 766, 772-73 (Bankr. D. Me. 1966) (suggesting literal reading furthers Code policies); *White v. Hancock Bank*, 477 So. 2d 265, 273 (Miss. 1985) (indicating need to faithfully apply and enforce Code).

"[t]he principle of the patent reason: Every provision should show its reason on its face. Every body of provisions should display on their face their organizing principle."<sup>16</sup>

An example of judicial deference to the practical authority of purpose is provided by the Official Comment to section 1-102, in which the drafters cite with approval a case in which the court "disregarded a statutory limitation of remedy where reason of the limitation did not apply."<sup>17</sup> In *Fiterman v. J. N. Johnson & Co.*,<sup>18</sup> the court permitted a buyer to rescind a contract for breach of warranty despite the buyer's inability to return to the seller all of the goods that were delivered.<sup>19</sup> The drafters made clear that "nothing in this act stands in the way of the continuance of such action by the courts."<sup>20</sup> Thus, we have found that courts continue to use policy to supersede the plain language of a particular Code section. Such is the interpretative force of the drafters' directive: "[T]he text of each section should be read in light of the purpose or policy of the rule in question."<sup>21</sup> And such is the nature of purposive interpretation as perceived by Llewellyn.

Before applying Llewellyn's directive to some of the decisions made by the Article 2 Drafting Committee, it is necessary to note that the Code exemplifies a general model of legislative drafting that is far different from that of an ordinary statute.<sup>22</sup> The Code

<sup>16</sup> Karl Llewellyn, Collection of Karl Llewellyn Papers, J, VI, I, e at 5 (1944), *quoted in* TWINING, *supra* note 6, at 321-22 (discussing Llewellyn's thoughts on Code construction, that interpretation should be based on reason behind language of Code).

<sup>17</sup> U.C.C. § 1-102 cmt. 1 (1995) (citation omitted).

<sup>18</sup> 194 N.W. 399, 400-1 (Minn. 1923).

<sup>19</sup> *See id.* at 401 (discussing return of inferior automobile tire casings as "specially manufactured goods" unable to be resold).

<sup>20</sup> U.C.C. § 1-102 cmt. 1.

<sup>21</sup> *Id.*

<sup>22</sup> *See* William D. Hawkland, *Uniform Commercial "Code" Methodology*, 1962 U. ILL. L.F. 291, 292 (discussing difference between code and statute). Since the Code was first drafted, several legal scholars have suggested that it meets the requirements of a "true code" in the continental sense of codification. For example, William D. Hawkland reaches this conclusion based on the following perceived difference between a "code" and a "statute":

A "code" is a pre-emptive, systematic, and comprehensive enactment of a whole field of law. It is pre-emptive in that it displaces all other law in its subject area save only that which the code excepts. It is systematic in that all of its parts, arranged in an orderly fashion and stated with a consistent terminology, form an interlocking, integrated body, revealing its own plan and containing its own methodology. It is comprehensive in that it is sufficiently inclusive and independent to enable it to be administered in accordance with its own basic policies.

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follows what has been described as a systems approach to lawmaking.<sup>25</sup> However, we should not simply assume that the Code is a self-contained system. Before we amend the Code we need to appreciate the connection between the substantive provisions of the Code and law external to the Code, as well as relevant commercial practices. The whole point is that the Code is only part of a much larger system. This is fast becoming conventional wisdom. For example, Professors Lynn M. Lopucki and Elizabeth Warren observe that:

Law is one of many elements that together constitute the secured credit system. To teach the law without teaching the system in which it is embedded would deprive the law of much of its meaning and make it more difficult to understand. But to teach the whole system requires discussion of institutions, people, and things that are not "law." Among them are sheriffs, bankruptcy

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. . . A mere statute, on the other hand, is neither preemptive, systematic, nor comprehensive, and, therefore, its methodology is different from that of a code.

*Id.*; see also JOHN HENRY MERRYMAN, *THE CIVIL LAW TRADITION* 28 (1969) (suggesting that UCC differs from other codes in comparative law); Mitchell Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 *LAW & CONTEMP. PROBS.* 330 (1951) (describing UCC as general code, limited only by content). Notwithstanding the obvious similarity between the UCC and a true code, "the underlying ideology — the conception of what a code is and of the functions it should perform in the legal process — is not the same. There is an entirely different ideology of codification at work in the civil law world." MERRYMAN, *supra*, at 28. Whatever its nature, it is clear to us that the Code is a very special type of legislative product.

<sup>25</sup> Professor Edwin W. Patterson, who was sensitive to the structural aspects of the Code, made this point when commenting on the Code for the New York Law Revision Commission. See 1 *STATE OF N.Y. LAW REVISION COMM'N REPORT; STUDY OF THE UNIFORM COMMERCIAL CODE* 65 (1980) [hereinafter *N.Y. COMM'N REPORT*]. What he meant by a "system" was:

A body of interrelated propositions about a common subject matter which are consistent with, and thus aid in the interpretation of each other. The characteristics of "system" are orderly arrangement in expression and the maintenance of consistent relations of super- and sub-ordination in content. By the latter is meant, not the deduction, demonstrable by a syllogism, of a subordinate rule from a "higher" principle; this is not the way that higher principles of law are ordinarily used. Three things, especially, seem to count for legal system: 1. That all exceptions to a specific code rule be stated with the rule or referred to in it by cross-reference to another provision. 2. That the code shall have enough "safety-valve" concepts or principles, or what one writer on comparative law has called "super-eminent" provisions to serve as justifications for modifying the harsh results of specific rules. 3. That the implied or underlying policies of the various provisions should be compatible with each other.

*Id.* at 65-66.

trustees, filing systems, security agreements, financing statements, search companies, Vehicle Identification Numbers, closing practices, collateral repurchase agreements, and a variety of other commercial and legal practices. Together with law from a variety of sources, these things constitute the system we know as secured credit . . . .<sup>24</sup>

This model has consequences for judge and drafter alike. If any truly rational approach to decision making under the Code requires consideration of the balance of all relevant policies, then the approach must weigh heavily the intrinsic value of maintaining the statute as a system of interdependent premises and conclusions.<sup>25</sup> This approach to Code interpretation furthers one of the declared goals of the original drafters: to develop "an integrated, comprehensive treatment of a single body of law, in which at least to a large extent particular rules represent merely the application in varying contexts of the same essential principles."<sup>26</sup> To ensure adequate protection of this value, today's Code drafters must view their task (at least in part) as making sure that the topics dealt with in the Code fit together in a logical way. This requires not only that the sections in each article be compatible, but, additionally, that there be a systematic tying together of the several articles. Moreover, when we turn to drafting, our ability to recommend particular decisions will depend upon our insight into the location of the doctrine in question within the entire commercial world order.

Having formulated Llewellyn's conceptual view of statutory interpretation and the systematic nature of the Code, we turn our attention to the most recent draft of the article 2 revision. We argue, and will demonstrate, that several of the decisions made by the Drafting Committee are inexplicable in terms of policy and fail to accommodate essential principles expressed elsewhere in the Code and, in some cases, in the law outside of the Code. From this perspective we suggest that the process by which the Code is cur-

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<sup>24</sup> Kathryn R. Heidt, *Taking a New Look at Secured Transactions*, 96 COLUM. L. REV. 759, 765-66 (1996) (reviewing LYNN M. LOPUCKI & ELIZABETH WARREN, *SECURED CREDIT: A SYSTEMS APPROACH* (1995)).

<sup>25</sup> Perhaps the most important benefit to be gained from codification of any subject area is that "it can be used to introduce order and system into the mass of legal concepts and ideas and so present the law as a homogeneous, related whole rather than as a series of isolated propositions." Ferdinand Fairfax Stone, *A Primer on Codification*, 29 TUL. L. REV. 303, 307 (1955).

<sup>26</sup> 1 N.Y. COMM'N REPORT, *supra* note 23, at 18.

rently drafted and revised does not provide the best possible results. We demonstrate the incongruities of the revision's current approach by focusing first on the provision of the buyer's right to recover goods upon the seller's insolvency.

## II. SPECIFIC EXAMPLE: UCC SECTION 2-502

Existing subsection (1) of section 2-502 formulates the right of a buyer to recover goods on a seller's insolvency. It reads:

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.<sup>27</sup>

This is a theoretical remedy, not a practical one. Upon reading the section, it is immediately noticeable that the remedy granted is destined to ever elude the grasp of most buyers who may wish to use it. To begin with, the buyer must have a "special property" in the goods under section 2-501.<sup>28</sup> In other words, the goods must be identified to the contract. Although this requirement poses no real problems for many buyers, it may make the section unavailable to a large portion of buyers who contract for specially manufactured goods.<sup>29</sup> Furthermore, there is the near impossible task of having to prove that the seller was solvent when it received the first installment and became insolvent ten days thereafter.<sup>30</sup>

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<sup>27</sup> U.C.C. § 2-502(1) (1998).

<sup>28</sup> See *id.* § 2-501(1) (1998).

<sup>29</sup> See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 220 (4th ed. 1995) (suggesting that identification of specially manufactured goods to contract does not occur until their completion); see also 3A RICHARD W. DUESENBERG & LAWRENCE P. KING, BENDER'S UNIFORM COMMERCIAL CODE, SALES AND BULK TRANSFERS UNDER THE U.C.C. § 9.05[3], at 9-50 to 9-51 (1998) (discussing effect on buyer when specially manufactured goods are destroyed before identification takes place). *But see* Little v. Grizzly Mfg., 636 P.2d 839, 842 (Mont. 1981) (holding that identification occurs at time of first step in production). Unfortunately, section 2-502(1) is silent on when the buyer's special property must vest. See WHITE & SUMMERS, *supra*, at 220 (assuming that goods must be identified within or prior to ten-day period after insolvency). *But see* ROBERT J. NORDSTROM, LAW OF SALES 484 (1970) (suggesting that UCC drafters likely intended that buyer must have special property at time buyer tendered balance of purchase price).

<sup>30</sup> See First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 179 S.E.2d 850, 854

The reality is that section 2-502, in its present incarnation, only pays lip service to the protective needs of the prepaying or financing buyer. This shortcoming led the Article 2 Study Group to recommend the section be repealed.<sup>31</sup> The Drafting Committee, however, has taken the opposite approach. Rather than scrap the section because of its restrictive limitations, the Committee has decided to strengthen the section by scrapping some of the limitations. Gone from the section is any mention of the seller's insolvency.<sup>32</sup> To be sure, this change will not solve all the possible problems; among other things, the buyer must still acquire a special property in the goods at the appropriate time. Still, it will provide the buyer with a remedy that is far more vigorous than the one presently available under section 2-502.

#### A. Policy Analysis

The most striking aspect of the current version of section 2-502 is its limited scope. The linchpin on which the remedy rests is the seller's insolvency within ten days after receipt of the first installment on the purchase price. There is a correlative provision in section 2-702 which allows sellers to reclaim goods sold on credit to an insolvent purchaser.<sup>33</sup> Taken together, these provisions are apparently premised on the notion that dealings by those who are insolvent, or at the brink of insolvency, are per se fraudulent without any further requirement that there be some form of active concealment or express misrepresentation.<sup>34</sup> Both sections 2-502

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(N.C. Ct. App. 1971) (holding that section 2-502 was inapplicable when seller was insolvent at time of initial payment).

<sup>31</sup> See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY GROUP UNIFORM COMMERCIAL CODE ARTICLE 2, PRELIMINARY REPORT 132 (Rec. A2.5(2)) (1990).

<sup>32</sup> See U.C.C. § 2-824 reporter's note 1 (Discussion Draft Jan. 24, 1997).

<sup>33</sup> This section reads, in pertinent part:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

U.C.C. § 2-702 (1998).

<sup>34</sup> See, e.g., U.C.C. § 2-702 cmt. 2 (stating that "[s]ubsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit

and 2-702(2) can, therefore, be explained as special remedies for tortious conduct. However, once the insolvency provision in section 2-502 is deleted, as proposed by the Drafting Committee, what justification is there for affording the buyer a right of specific recovery?<sup>55</sup>

Section 2-502 may still be justified under the theory that it provides a more realistic and certain recovery for the buyer who can show actual reliance on the contract. This conclusion is easily supported if section 2-502 allows buyers to recover based on any type of reliance. However, section 2-502 does not allow recovery based on any reliance, rather 2-502 requires reliance in the form of prepayment. This requirement leads to the odd result that a buyer who relies substantially, but does not prepay, will not recover under 2-502, but a buyer whose reliance is in the form of prepayment, no

business misrepresentation of solvency and therefore is fraudulent as against the particular seller"); 1 N.Y. LAW COMM'N REPORT, *supra* note 23, at 467 (stating that "[i]t might be suggested in support of section 2-502 that if seller receives an advance cash payment immediately before he becomes insolvent, the possibility that fraud was perpetrated on buyer justifies a general statutory rule affording buyer specific reparation").

<sup>55</sup> See U.C.C. § 2-824 reporter's note 2 (Discussion Draft Jan. 24, 1997) (providing that prepaying buyer's remedy was broadened because such buyers, "especially consumer buyers, should have some protection under Article 2"). Quite clearly this is not an answer to the central question. Interestingly, revised article 9 amends section 2-502 as follows:

**BUYER'S RIGHT TO GOODS ON SELLER'S REPUDIATION, FAILURE TO DELIVER OR INSOLVENCY.**

- (1) Subject to subsections (2) and (3) 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 then from the seller if:
  - (a) 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
  - (b) in other cases, the seller becomes insolvent within ten days after receipt of the first installment on their price.
- (2) The buyer's right to recover the goods under subsection (1)(a) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver,
- (3) 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 (Discussion Draft Mar. 1, 1998) (visited Nov. 10, 1998) <<http://www.law.upenn.edu/library/ulc/ucc9/m14draft.htm>> (on file with author). This change to section 2-502 was made as part of a more general compromise with consumer advocates. Of course, if the Article 2 Drafting Committee does not decide to change the current scope of its proposed 2-502, then all buyers would receive the benefits of this new remedial right.

matter how small the payment, may recover under section 2-502.

Consider a simplified example involving two buyers (B1 and B2). Each buyer contracts with Seller to purchase a machine for \$100,000. In both cases identification of the machine occurs when the contract is made. B1 makes an advance payment of \$10 on the purchase price. B2 makes no prepayment on the purchase price. What are the respective rights of B1 and B2 under section 2-502 if Seller repudiates the contract or otherwise fails to deliver either machine? Presumably B1 has a right of specific recovery and B2 does not. In terms of their reliance on the contract is there any real difference between the two buyers? The answer must be no. Suppose, however, that B2 relies on the contract in other, more substantial ways. For example, assume that B2 modifies its physical plant to accommodate the machine. Would that change the result under section 2-502? Again, the answer is no.<sup>36</sup>

From the foregoing example, it is fair to assume that the principle motivation of the drafters in revising section 2-502 is generally not to protect the reliance interest. However, this point, standing alone, does not show that they did not have the more narrow purpose of protecting a particular form of reliance — namely, payments made on the contract price. Perhaps one can explain the revision by the fact that a prepaying buyer stands to suffer in a way sufficiently distinct from all other buyers so as to warrant a different remedy. Even accepting the validity of such a premise (which we do not), the potential operation of section 2-502 makes us question whether this can be the actual policy rationale. In order to understand our skepticism, it is necessary to consider a second example.

Assume the same facts as in the first example, except that B2 contracts with Seller to purchase the machine previously purchased by B1 and makes a prepayment of \$75,000. What would be the result? If the purpose of new section 2-502 is perceived to be the

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<sup>36</sup> It still may be that B2 will be able to recover the machine under section 2-716, which defines the circumstances in which both specific performance and replevin are available. The Code reserves specific performance for those cases “where the goods are unique or in other proper circumstances.” U.C.C. § 2-716(1) (1998). Replevin, the second remedy in section 2-716 is conferred “if after reasonable effort [the buyer] 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(3). If we assume a vast and easily accessible market for similar machines, we doubt that even the most liberal-minded judge could find in the text of section 2-716 a reason why B2 should be given a proprietary power over the machine.



protection of a particular form of reliance (i.e., prepayment), it would not be strictly faithful to that goal if B2 would be deprived of its ability to claim the machine. Yet, we believe the Code would dictate a result in favor of B1.

In article 2, the general conveyancing principle appears in section 2-403(1): "A purchaser of goods acquires all title which his transferor had or had power to transfer . . ." <sup>37</sup> So in the absence of a statutory or common law exception, article 2 follows the derivation principle of *nemo dat* <sup>38</sup> and provides that B2 takes the machine subject to the property interest created by the possessory remedy afforded B1 under section 2-502. <sup>39</sup> Unless a court would be willing to characterize the seller's interest as "voidable title," there is no exception in the Code, or otherwise, to the general rule in section 2-403(1). <sup>40</sup>

In sum, we are unable to discern a coherent policy rationale for

<sup>37</sup> U.C.C. § 2-403(1) (1998).

<sup>38</sup> The complete Latin maxim is *nemo dat quod non habet* (one cannot give what one does not have). See John F. Dolan, *The U.C.C. Framework: Conveyancing Principles and Property Interests*, 59 B.U. L. REV. 811, 811-20 (1979) (discussing three conveyance principles: shelter principle, good faith purchase, and Twyne Rule); Steven L. Harris, *The Interaction of Article 6 and 9 of the Uniform Commercial Code: A Study in Conveyancing, Priorities, and Code Interpretation*, 39 VAND. L. REV. 179, 194-201 (1986) (discussing conveyancing principles that underlie Code); see, e.g., Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1057-1107 (1954) (discussing development of good faith purchase doctrine). *Nemo dat* dictates that the transferee takes its interest subject to all third-party claims and interests that were enforceable against the transferor. This principle is not confined to article 2. See generally U.C.C. §§ 3-305(a), 3-306, 7-504, 8-302, 9-318 (1998).

<sup>39</sup> This statement is based on the assumption that property interests are defined by the availability of a remedy that permits a person to exercise dominion over the specific asset or to exclude the exercise of dominion by others. See also 1 N.Y. COMM'N REPORT, *supra* note 23, at 578 (stating "[i]t is not easy to grasp the substance behind a notion that buyer has 'property' in goods when he does not have power to compel their delivery, or risk of loss, and has at most the opportunity to insure his expectation of receiving then goods"). See generally David Frisch, *Remedies as Property: A Different Perspective on Specific Performance Clauses*, 35 WM. & MARY L. REV. 1691, 1695-1717 (1994) (discussing relationship between legal remedies and protected property interests). If B1 were denied the use of section 2-502 and all similar possessory remedies such as specific performance, the result would be different. She would have no existing property interest in the machine that would continue following its sale to B2.

<sup>40</sup> The second sentence of section 2-403(1) provides that "[a] person with voidable title has power to transfer a good title to a good faith purchaser for value." U.C.C. § 2-403(1). Although the term "voidable title" is undefined, the examples given by the drafters in the text of section 2-403 suggest that it is a concept reserved for buyers. See *id.* § 2-403(1)(a)-(d). The only other statutory exception to *nemo dat* that might conceivably be relevant is the entrustment rule of section 2-403(2), which reads as follows: "[a]ny entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." *Id.* § 2-403(2). Has there been an entrusting? Unless B1 can be said to have acquiesced in seller's retention of possession, the answer is no.

the drafters' decision to delete the requirement of the seller's insolvency from section 2-502.<sup>41</sup> If the purpose were to protect the reliance interest, then why is the remedy only available to those buyers who prepay? If, on the other hand, the goal was to afford a special remedy to those buyers who happen to rely in a specific way, then why should the relative degree of reliance not matter?

### B. Systemic Concerns — Within the Code

Questions about relationships, in addition to that of buyer and seller, complicate the normative analysis of any proposed change to article 2. Before we can say that the decision to revise section 2-502 is justified, one must consider how the new section will mesh with the many concepts and provisions that form the interlocking Code system of commercial law. Unfortunately, the focus of the Article 2 Drafting Committee has primarily been on issues pertaining to the effects of its decisions on sales law. As this part of the Article will demonstrate, sales policies also raise questions about the rights of third parties, including questions about how to balance article 9 security interests with the Code's cutoff of those interests in favor of certain buyers of the collateral.<sup>42</sup>

Buyer in the ordinary course of business concerns provide the

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<sup>41</sup> In a very real sense, a buyer who prepays is buying a limited form of specific performance. The section 2-502 remedy is a less complete remedy only because it requires goods that have been identified to the contract, whereas specific performance under section 2-716 is not so limited. Ironically, once sellers learn that they are, in essence, agreeing to specific performance every time they accept a prepayment, we may expect to see an increase in the price that prepaying buyers are asked to pay. The "law and economics" scholarship tells us that if specific performance is available to the buyer, she, rather than the seller, will enjoy whatever surplus is made possible by the appearance of a second buyer who values the goods more than does the first buyer. See, e.g., WHITE & SUMMERS, *supra* note 29, at 218:

If, on the other hand, Buyer One has a right to specific performance, he has the power to enjoy the surplus by getting the goods and, himself, reselling them to Buyer Two. Of course, this does not necessarily cause an efficiency gain, but causes a wealth transfer or allocation from the original seller in a damage regime to aggrieved buyers in a specific performance regime.

*Id.* Presumably, sellers will wish to be compensated for giving up the expected value of the gain that could be earned if they were permitted to transfer performance freely in order to consummate the efficient breach. See *id.* at 218-19.

<sup>42</sup> Article 9 secured parties would not be the only third parties affected by the proposed change to section 2-502; they are just one example. For instance, the textual discussion will apply with equal force if the third party is an "owner" who has entrusted goods with a merchant having the power under section 2-403(2) to transfer the owner's interest in the goods to a buyer in the ordinary course of business.

clearest path into our article 9 analysis. To illustrate the most basic aspect of the problem, let us suppose that Seller borrows money from Bank and grants Bank a security interest in its then existing and after-acquired inventory of boats. Some time later, Buyer contracts with Seller to purchase one of the boats. For whatever reason, Buyer makes the decision to pay part or all of the purchase price without taking delivery of the boat. If the boat is still in Seller's possession when Bank acquires the right and makes the decision to proceed against its collateral, will Bank still have a security interest in the boat that was sold to Buyer?<sup>43</sup>

In considering this case, the court will look to the good faith purchase doctrine in section 9-307, which provides: "[A] buyer in the ordinary course of business . . . takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence."<sup>44</sup> In our hypothetical the court will have to struggle with the Code's definition of "buyer in ordinary course of business."<sup>45</sup> Buyer will argue that the

<sup>43</sup> This hypothetical was inspired by the case of *Holstein v. Greenwich Yacht Sales, Inc.*, 404 A.2d 842, 843-45 (R.I. 1979) (indicating that individual may become buyer at time of identification rather than time of delivery). Irrespective of whether the security interest continues in the boat, the secured party will have a security interest in the cash proceeds, provided that they remain identifiable. See U.C.C. § 9-306 (1)-(3) (1998).

<sup>44</sup> U.C.C. § 9-307(1) (1998).

<sup>45</sup> The text of section 1-201(9) provides the following definition of buyer in ordinary course:

[A] person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a preexisting contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

U.C.C. § 1-201(9) (1998). What the definition does not tell us is when during the progression of a sales transaction the purchaser will qualify as a protected buyer. See David Frisch, *Buyer Status Under the U.C.C.: A Suggested Temporal Definition*, 72 IOWA L. REV. 531, 534-40 (1987) (concluding that buyer status occurs when buyer obtains remedial right to goods with regard to seller). It should be noted that the proposed revised draft of article 9 contains a revised definition of buyer in the ordinary course. The revision resolves a previous ambiguity by specifying that only a buyer that takes possession, or one that has a right to the goods under article 2, may be a buyer in the ordinary course of business:

"Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than

court should invoke the policies underlying the good faith purchase doctrine, thus giving Buyer the protection of section 9-307(1).<sup>46</sup> On the other hand, Bank will argue that the sales transaction had not yet progressed to the point at which buyer status arises.<sup>47</sup> Faced with an ambiguous statute and the absence of clear guidance from case law on the issue of when buyer status is achieved, the resulting jurisprudence remains, at best, ad hoc.<sup>48</sup>

The lack of clarity in this area of the law is the result of many courts' willingness to use the good faith purchase doctrine to protect the buyer, even where the buyer has no possessory remedy against the immediate seller. Simply put, if the seller has not yet delivered the goods and the buyer does not have the legally cognizable power to wrest the goods from the seller's possession, the buyer should not be able to take advantage of a doctrine that is premised on the implicit assumption that the buyer has a title expectation needing protection. Future delivery is speculative because the seller may cease doing business or decide to direct the goods elsewhere. The good faith purchase doctrine was never intended to cleanse the seller's title to speculative goods. So long as

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a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a pre-existing contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Section 2-~~XXXX~~ Article 2 may be a buyer in ordinary course of business. A person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in ordinary course of business.

U.C.C. § 1-201(9) (Discussion Draft Mar. 1, 1998) (visited Nov. 10, 1998) <<http://www.law.upenn.edu/library/ulc/ucc9/ml4draft.htm>> (on file with author).

<sup>46</sup> See U.C.C. § 9-307(1). The good faith purchase doctrine, which is embodied in this section, seeks to facilitate market trading by reducing title uncertainty. See *id.* See generally Gilmore, *supra* note 38 (describing good faith purchase doctrine in commercial context).

<sup>47</sup> Bank may argue that buyer status cannot be achieved until Buyer obtains possession of the boat. Although authority for such a position is scant, it does exist. See, e.g., Hale M. Smith, *Title and Right to Possession Under the Uniform Commercial Code*, 10 B.C. INDUS. & COM. CODE 39, 64 (1968) (arguing that buyer must obtain possession of goods).

<sup>48</sup> See *Big Knob Volunteer Fire Co. v. Lowe & Moyer Garage, Inc.*, 487 A.2d 953, 957 (Pa. Super. Ct. 1985) (holding that "[t]he point at which a person becomes a buyer in ordinary course is subject to considerable controversy because the Code does not specify the moment at which the status is conferred"); Frisch, *supra* note 45, at 540-68 (discussing commonly accepted alternatives for pinpointing moment that buyer status is achieved).

the buyer is able to obtain a judgment for damages, he receives a bargain that ought to have been within his range of reasonable expectations.<sup>49</sup> The buyer's title concerns crystallize once he obtains the power to compel the seller's performance. It is then that the buyer's legitimate claim to good faith purchase treatment materializes.<sup>50</sup>

It should now be pointed out that section 2-502, in its proposed form, turns a buyer's speculative expectation into a possessory right. Thus, section 2-502 in conjunction with the good faith purchase doctrine will, in limited circumstances, cause a creditor's secured interest to be stripped away in favor of a prepaying buyer of the collateral. Therefore, if the barriers to 2-502 are removed, as the Drafting Committee proposes, new policy concerns come into play. Quite clearly, the proposed change has the potential to shift the Code's balance of protection from secured parties to buyers. Whether this is desirable will depend on a conscious application of commercial law policies such as "clarity, simplicity, flexibility, fairness, consistency, and completeness."<sup>51</sup> Our argument is that the drafters cannot simply ignore systemic aspects of the Code. The

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<sup>49</sup> A central assumption of article 2 is the homogeneity of goods. If the seller does not deliver the goods, the buyer will, most often, be able to obtain similar goods elsewhere. See U.C.C. § 2-713 (1998) (vindicating buyer's expectation interest by damage award based on market price); U.C.C. § 2-712 (1998) (vindicating buyer's expectation through actual substitute purchase).

<sup>50</sup> See generally Frisch, *supra* note 39 at 1717-49 (arguing at length that existing case law is deeply flawed by its failure to attend to functional relationship between good faith purchase doctrine and Code's remedial rules). Although the argument in the text that the rights of the buyer should turn on the existence of a proprietary power over the goods may seem to be of theoretical interest only, we anticipate that this view will soon find expression in the Code. See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY GROUP UNIFORM COMMERCIAL CODE ARTICLE 9 REPORT 191-92 (1992).

Permitting a putative buyer of goods to become a buyer in ordinary course of business from a seller before the buyer obtains possessory rights against the seller would produce a strikingly anomalous result: The buyer could take free of the rights of the seller's secured party pursuant to § 9-307(1) even though the buyer would have no right to possession of the goods as against the seller. The seller's secured party, on the other hand, does have a right to possession as against the seller . . . section 1-201(9) should be revised to make clear that the earliest time that a putative buyer can achieve buyer status under that definition is the time that the buyer obtains possessory rights against its seller.

*Id.* (footnote omitted).

<sup>51</sup> Steven L. Schwarcz, *A Fundamental Inquiry Into the Statutory Rulemaking Process of Private Legislatures*, 29 GA. L. REV. 909, 924-25 (1995) (discussing Llewellyn's theories on constraints on rulemaking, and concluding that he adds "completeness" beyond the five constraints previously established).

connections between Code sections and Code articles need to be appreciated when considering whether to revise a provision. The ability to recommend changes coherently will depend on the insight into the location of the provision within the entire commercial law order. By embracing the Code as a system, it is possible to maintain it as a coherent, practically sensible whole.

### C. Systemic Concerns — Outside the Code

Once one appreciates that the Code is part of a larger commercial law system, doctrinal questions faced by the drafters take on a different character. They no longer pose only questions about, for example, the relationship between buyer and seller. They also involve concrete questions about the maintenance of policies that underlie other statutory schemes. Bankruptcy law provides a ready example of the broader context in which the Code operates.<sup>52</sup>

Equality of distribution among creditors is one of the fundamental policies of modern bankruptcy law.<sup>53</sup> It is easy to show how requiring the seller (now the “debtor”) to turn over the goods pursuant to section 2-502 would profoundly affect the buyer’s position in bankruptcy and that of the seller’s other creditors as well. Assume that prior to Seller’s bankruptcy, Buyer paid \$10,000 for goods to be delivered sometime in the future. Assume further that, at all relevant times, the goods have a market value of \$11,000. Without the availability of section 2-502, Buyer’s unsecured claim of \$11,000 would be paid in “bankruptcy dollars” and the full value of the goods would be available for distribution to creditors generally as part of the bankruptcy estate.<sup>54</sup> With the availability of section 2-

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<sup>52</sup> Code revisions may also have consequences that are procedural in nature. Query whether the right to a jury trial will be lost if the buyer is seeking only to recover the goods under 2-502? See generally John C. McCoid, II, *Procedural Reform and the Right to Jury Trial: A Study of Beacon Theatres, Inc. v. Westover*, 116 U. PA. L. REV. 1, 15-23 (1967) (examining effect of procedural changes in previous legal remedies).

<sup>53</sup> See Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 735-36 (1991) (asking reader to “[c]onsider one of the most pervasive doctrines in bankruptcy law: the rule of equality of distribution among similarly situated creditors”).

<sup>54</sup> See U.C.C. § 2-711(1) (1998) (providing that non-bankruptcy formula for measuring Buyer’s damages is prepayment); U.C.C. § 2-713(1) (measuring Buyer’s damages as difference between market price when Buyer learned of breach and contract price). In bankruptcy, the reality is that the Buyer will recover, if anything, only a percentage of this total amount. In other words, relieving the estate from the duty of specifically complying with the contract increases the value of the Seller’s assets. See also Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 255-57 (1989) (discussing denial of specific performance against trustee).

502, Buyer would receive the goods and Buyer's prepetition claim would ultimately be satisfied in full. In short, allowing Buyer to recover the goods during the bankruptcy proceeding would undermine bankruptcy's pro rata sharing rule.

Forcing the buyer to play by the same rules as everyone else is undesirable if it would prevent a distribution of assets according to preexisting property interests. Consider, for example, the distributional rights of secured creditors. Obviously, other creditors would be harmed if the allowed secured claim must be paid off at 100 cents on the dollar. However, the preferential treatment of secured creditors is not only permitted, it is mandated by the underlying property interest.<sup>55</sup> Indeed, "[t]his property principle is central to bankruptcy law because it is by far the most important exception to the principle of equality of distribution."<sup>56</sup> The problem, of course, is determining whether an interest in a specific asset is property for bankruptcy purposes.<sup>57</sup>

In evaluating whether a creditor's claim represents an interest in property, a bankruptcy court should look to the relevant attributes of the claim outside of bankruptcy. The United States Supreme Court took this approach in *Nobelman v. American Savings Bank*,<sup>58</sup> where the Court explained:

In the absence of a controlling federal rule, we generally assume that Congress has "left the determination of property rights in the assets of a bankrupt's estate to state law," since such "[p]roperty interests are created and defined by state law." Moreover, we have specifically recognized that "[t]he justifications for application of state law are not limited to ownership interests . . . ."<sup>59</sup>

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<sup>55</sup> See *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 601-02 (1935) (stating that Fifth Amendment prohibits taking of property of mortgagees to relieve burdens of mortgagors); see, e.g., JAMES J. WHITE & RAYMOND T. NIMMER, *CASES AND MATERIALS ON BANKRUPTCY* 428 (3d ed. 1996) (stating that "[t]he provisions of sections 361, 362, and 1129 ensure that the secured creditors retain 'the benefit of their bargain' as envisioned by Congress"). Moreover, the Supreme Court has held that the Takings Clause prohibits any attempt, statutory or otherwise, to reduce involuntarily the amount of a secured creditor's lien for any reason other than payment on the debt.

<sup>56</sup> Westbrook, *supra* note 54, at 257.

<sup>57</sup> See 11 U.S.C. § 541 (1994) (listing property interest comprising estate).

<sup>58</sup> 508 U.S. 324, 332 (1993) (holding section 1322(b)(2) forbids debtor from relying on section 506(a) to reduce under second mortgage to fair market value).

<sup>59</sup> *Id.* at 329 (quoting *Butner v. United States*, 440 U.S. 48, 54-55 (1979)) (citations omitted).

The existence of a property interest depends upon the availability of a remedy that permits the interest holder to exercise dominion over the specific asset or to exclude the exercise of dominion by others.<sup>60</sup> Such is the nature of section 2-502. It would seem to follow, therefore, that the property interest created by section 2-502 may be enforced in the seller's bankruptcy.

Nevertheless, there are grounds to hesitate. A second aspect of the recognition of property interests in bankruptcy lies in the application of the trustee's avoidance powers.<sup>61</sup> Even a property interest enforceable in the abstract may become invalid and unenforceable in various circumstances. It is to these limitations that we now turn. In doing so, it is helpful to distinguish between cases in which the goods are received by the buyer prior to the time the seller files a bankruptcy petition and those cases where they are not.

### 1. Where the Buyer Has Received the Goods

If the seller delivers the goods within ninety days prior to the time that seller's bankruptcy petition is filed, the trustee's avoidance power under section 547 is the most likely to create problems for the prepaying buyer. Section 547 allows the trustee to avoid a prepetition preferential transfer.<sup>62</sup> Under the current version of

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<sup>60</sup> See Frisch, *supra* note 39, at 1691-1717 (arguing that nature of remedies available best determines whether "property right" exists).

<sup>61</sup> See 11 U.S.C. §§ 544-549 (1994) (giving avoidance power and setting limits).

<sup>62</sup> See *id.* § 547(b). This section reads as follows:

- (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property —
  - (1) to or for the benefit of a creditor;
  - (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
  - (3) made while the debtor was insolvent;
  - (4) made —
    - (A) on or within 90 days before the date of the filing of the petition; or
    - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
  - (5) that enables such creditor to receive more than such creditor would receive if —
    - (A) the case were a case under chapter 7 of this title;
    - (B) the transfer had not been made; and



section 2-502, the buyer faces the prospect of having to return the goods received during the preference period or to disgorge their value, while the trustee gets to keep the full amount of the payments made. The theory is that the prepayment on the price was the antecedent debt on account of which the later transfer took place. The crucial point is this: the transfer must necessarily occur after the debt is incurred. If the buyer cannot meet the requirements of section 2-502 (because of the ten-day requirement the section will be unavailable to most buyers) then the transfer is complete when the goods are delivered. Alternatively, if the buyer does qualify under section 2-502 before delivery, then the transfer would occur when the remedy vests. This takes place on insolvency which occurs after receipt of the price.<sup>63</sup> Either way, the transfer is a preference.

Under the new version of section 2-502, it will no longer be inevitable that the debt will precede the transfer. The reason is that the seller's insolvency will no longer matter. Once this requirement is dropped from the section, the conditions of section 2-502 will be met when the downpayment is made. On this view, there can be no preference because there is no antecedent debt.<sup>64</sup>

## 2. Where the Buyer Has Not Received the Goods

Where the buyer has prepaid for the goods and all that remains is the seller's performance, it is unlikely, today, that the trustee will be under an obligation to deliver the goods. This result should change, however, once section 2-502 becomes available to the buyer. This conclusion embodies two assumptions: First, if the contract is "rejected" by the trustee it will have no effect on the buyer's proprietary power over the goods. Second, the trustee is

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(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

*Id.*

<sup>63</sup> We are assuming that the seller's insolvency also occurred within the 90 day preference period.

<sup>64</sup> If the property interest created by section 2-502 cannot be avoided in bankruptcy, it matters not that the goods were subsequently delivered (i.e., there is no preference). If the seller had not delivered the goods, the buyer could have gotten them anyway under section 2-502. Thus, one of the elements of a preference (the creditor must be better off because of the transfer) would not be satisfied. Moreover, if the relevant transfer is deemed to occur when the section 2-502 remedy vests, one could argue that when the goods are later delivered there is no transfer, but merely a change of possession.

not able, by virtue of enjoying the powers of a lien creditor, to avoid the buyer's property interest.<sup>65</sup> The following discussion thus focuses, in turn, on these two assumptions.

If a prebankruptcy contract is deemed "executory," it can be rejected (subject to court approval) by the trustee.<sup>66</sup> Rejection "constitutes a breach of such contract . . . (1) . . . immediately before the date of the filing of the petition . . ."<sup>67</sup> In assessing the fate of the buyer's contract, therefore, one should first decide whether the contract is executory. Although the term "executory contract" is fundamental to the application of section 365, it is nowhere defined in the Bankruptcy Code.<sup>68</sup> According to Professor Vern Countryman's classic definition, an executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."<sup>69</sup> This inquiry pre-

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<sup>65</sup> See 11 U.S.C. § 544 (discussing trustee as lien creditor).

<sup>66</sup> See *id.* § 365(a) (1994) (governing treatment of "unexpired leases" and "executory contracts").

<sup>67</sup> *Id.* § 365(g) (providing that rejection of executory contracts is generally considered breach); see also *id.* § 502(g) (1994) (stating that "[a] claim arising from the rejection, under section 365 . . . shall be determined, and shall be allowed . . . the same as if such claim had arisen before the date of the filing of the petition").

<sup>68</sup> "Executoriness" is probably the most enigmatic concept of section 365. In cases of contracts of modest complexity, lawyers and supposedly disinterested judges could often argue almost too easily for sharply conflicting, yet credible notions of when a contract is executory. The court in *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 687 (Bankr. S.D.N.Y. 1992), commented on this dilemma:

After grappling with the issues presented by the parties, we believe that we could, using existing "executoriness" precedent, plausibly justify any number of results, from affording either party the complete relief it seeks, to deciding the case as we actually do. While "executoriness" analysis can provide a reason for any result we might reach, we find it useless as a tool for reaching a reasoned result.

*Id.* at 696.

<sup>69</sup> Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973) (asserting that rejection of non-executory contracts should not be treated as material breach). Courts that have relied on this definition include *In re Terrell*, 892 F.2d 469, 471-72 (6th Cir. 1989) (determining whether land sale contract is executory under state law); *In re Streets*, 882 F.2d 233, 234-35 (7th Cir. 1989) (finding that installment land contract is not executory); *Sharon Steel Corp. v. National Fuel Gas Distrib. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989) (finding that natural gas utilities service agreement is executory); *Draper v. Draper*, 790 F.2d 52, 54 (8th Cir. 1986) (reserving judgment on whether divorce settlement is executory contract); *Gloria Mfg. Corp. v. International Ladies' Garment Workers' Union*, 734 F.2d 1020, 1021-22 (4th Cir. 1984) (discussing executory contracts in context of collective bargaining agreements).

sumably renders the buyer's contract executory if the buyer has not paid in full.

In any event, if the contract is executory, what are the consequences that flow from its rejection? Traditionally, courts and commentators conceived of rejection as a process by which all property interests created by the contract are wiped out and rendered unenforceable.<sup>70</sup> That is, rejection not only triggers a prepetition claim for damages, but also operates as an avoiding power.<sup>71</sup> In this conception of rejection, the seller is relieved from having to perform under section 2-502.<sup>72</sup> Within the past several years a very different conception of rejection has emerged in both judicial and scholarly literature, one that challenges the traditional assumption regarding what it means to reject an executory contract.<sup>73</sup> This emerging conception is a realization that rejection "does not invalidate, rejudicate, repeal, or avoid"<sup>74</sup> the contract. As a result, more and more courts are concluding that section 365 is not an avoiding power that can be used to destroy a right in or to property created by contract.<sup>75</sup>

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<sup>70</sup> See, e.g., *Lubrizol Enters. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985) (stating that district court misunderstood law when it determined that rejection of executory contract could not deprive Lubrizol of all contractual rights); *In re O.P.M. Leasing Servs.*, 23 B.R. 104, 118 (Bankr. S.D.N.Y. 1982) (stating that trust can reject executory contract lease if it will benefit estate).

<sup>71</sup> See *Lubrizol*, 756 F.2d at 1048 (discussing remedy available to non-bankruptcy party upon rejection of executory contract and other consequences of such rejection).

<sup>72</sup> It is this reasoning that has led some courts to conclude that specific performance is not a remedial option following rejection. See, e.g., *Leasing Serv. v. First Tenn. Bank Nat'l Ass'n*, 826 F.2d 434, 436 (6th Cir. 1987) (stating that rejection of executory contract denies creditors right to specific performance); *In re Waldron*, 36 B.R. 633, 642 n.4 (Bankr. S.D. Fla. 1984) (stating that specific performance is not available remedy for rejection of executory contract); *In re Roman Crest Fruit, Inc.*, 35 B.R. 939, 949 (Bankr. S.D.N.Y. 1983) (stating that when executory contract is rejected, specific performance cannot be ordered).

<sup>73</sup> See *In re Walnut Assocs.*, 145 B.R. 489, 494 (Bankr. E.D. Pa. 1992) (stating that rejecting executory contract does not repeal contract); *In re Seymour*, 144 B.R. 524, 530 (Bankr. D. Kan. 1992) (stating that rejection of contract is not "avoiding power"); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992) (stating that rejection does not get rid of contract); see also Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 3-11 (1991) (discussing practical consequences of party rejecting executory contract); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. COLO. L. REV. 845, 877-81 (1988) (discussing meaning of rejection as used in section 365 of Bankruptcy Code); Westbrook, *supra* note 54, at 282-84 (arguing that "executoriness" requirement be abolished so no finding of executory contract is necessary before rejecting bankruptcy contract).

<sup>74</sup> *In re Walnut Assocs.*, 145 B.R. at 494 (asserting that rejection of executory contract does not invalidate contract, but precludes administrative claims on debtor's estate by creditors).

<sup>75</sup> See, e.g., *id.*

Thus, if section 2-502 is a remedial option under state law, it ought to survive the contract's rejection in bankruptcy. The important point, whether the contract is executory or executed, is the impact of the trustee's avoidance powers on section 2-502. The particular avoidance power that must be considered when the seller has yet to perform is the "strong arm" power under section 544(a).<sup>76</sup>

Section 544(a) provides the trustee the rights of a hypothetical lien creditor.<sup>77</sup> Under Section 544(a), the trustee has the power to avoid a transfer or obligation in the same manner that a hypothetical creditor would where the hypothesized creditor extends credit and obtains a judicial lien against the debtor at the commencement of the bankruptcy case.<sup>78</sup> So the question is whether the trustee, as hypothetical lien creditor, takes an interest in the debtor's property subject to the buyer's right to receive the goods under section 2-502. Article 2 contains a provision that explicitly subordinates the rights of a seller's unsecured creditors (presumably judicial lien creditors) against goods in which the buyer has a specific proprietary interest. Section 2-402(1) provides: "Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's right to recover the goods under this Article (Sections 2-502 and 2-716)."<sup>79</sup> Thus, it seems that the trustee, even as hypothetical lien creditor, is powerless to retain the goods.

Precisely for this reason, the proposed change to section 2-502 would give the buyer an advantage over other unsecured creditors who have extended prepetition credit to the seller and whose claims have an equally strong moral basis. Just how differently situated creditors should be treated in bankruptcy is, of course, an enormously controversial question.<sup>80</sup> It is just because this question

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<sup>76</sup> We are assuming that the seller's retention of possession is not fraudulent under state law and that the contract price is roughly equivalent to the value of the goods. If either assumption turns out to be incorrect, the buyer's property interest is subject to fraudulent conveyance challenge in bankruptcy. See 11 U.S.C. §§ 544(b), 548(a) (1994).

<sup>77</sup> See *id.* § 544(a) (stating that "trustee shall have . . . the rights and powers of . . . (1) a creditor . . . or (3) a bona fide purchaser of real property").

<sup>78</sup> See *id.*

<sup>79</sup> U.C.C. § 2-402(1) (1998).

<sup>80</sup> See generally Bryan D. Hull, *A Void in Avoidance Powers? The Bankruptcy Trustee's Inability to Assert Damages Claims on Behalf of Creditors Against Third Parties*, 46 U. MIAMI L. REV. 263, 268-78 (1991) (examining void in bankruptcy trustee's power); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 859-60 (1982)

is controversial and intensely political, however, that isolated groups (e.g., the Article 2 Drafting Committee) should not impose their answers to questions of asset distribution without a dialogue with the broader bankruptcy community of academics and practitioners. In the end, such decision making runs the risk of legislating the wrong policy choices.

There are additional contexts that determine the efficiency of statutory commercial law formulations. It is to those that we now turn.

### III. THE UCC IN A COMMON LAW AND HISTORICAL CONTEXT

#### A. *The Complementary Common Law*

The UCC is, in substantial ways, carved out of its context, the contract law. Section 1-103 acknowledges and posits the fit between each of the articles of the Code and the rest of the universe of law apposite to commercial transactions within the scope of the UCC.<sup>81</sup> There are numerous instances in which the Code, particularly article 2, either cooperates with or conflicts with the complementary bodies of statutory and common law.<sup>82</sup> The courts have generally been adept at sorting through the related legal sources and arriving at conclusions that do not compromise the integrity of the Code.<sup>83</sup>

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(justifying recognition of non-bankruptcy entitlements in bankruptcy proceeding using "creditors" bargain model).

<sup>81</sup> Supplementary General Principles of Law Applicable.

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

U.C.C. § 1-103 (1998).

<sup>82</sup> See, e.g., *Palmer v. Idaho Peterbilt, Inc.*, 641 P.2d 346, 348 (Idaho Ct. App. 1982) (stating that "existing general principles of law may only 'supplement' the Idaho U.C.C. to the extent they are not displaced. General principles will not be applied where they conflict with particular provisions of the Code."); see also *City Dodge, Inc. v. Gardner*, 208 S.E.2d 794, 796-97 (Ga. 1974) (holding that adoption of Georgia statute did not bar remedy traditionally available under Georgia law). The court noted in *City Dodge* that "while the [Uniform Commercial] Code is an attempt to make uniform the law . . . regarding commercial transactions, the draftsmen realized that it could not possibly anticipate all situations." *Id.* at 796. Code section 1-103 reflects the draftsmen's reasoning. *Id.* at 796-97.

<sup>83</sup> See, e.g., *City Dodge*, 208 S.E.2d at 797 (reviewing Georgia's case law, case law of other states, and treatises supporting court's conclusion that tort remedy for fraud exists notwithstanding enactment of UCC).

Since the time of the Code's initial promulgation,<sup>84</sup> the complementary statutory and common law have evolved in ways that test their fit with the Code. Indeed, one very good reason to revise an article of the Code is to appreciate that type of evolution and revisit the terms of the Code's relationship with the complementary law. Conceptions of privity, fraud, and agreement, for example, are too fundamental to the fabric of the law generally to imagine that they could remain static as transactional patterns evolve. Further, the Code was first promulgated during dynamic times in the development of our economy<sup>85</sup> and our appreciation of transactor rights not dealing at arms' length has since matured.<sup>86</sup> What fit snugly

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<sup>84</sup> The first official text of the Code was promulgated in 1951. See William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1, 1-7 (1967) (discussing history of Code enactment and ratification). In 1953, Pennsylvania became the first state to enact the Code. See *id.* at 8. New York did not enact the Code until 1962, after study and review by its Law Revision Commission. See *id.* at 9.

<sup>85</sup> See Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L.J. 1341, 1356-58 (1948). Grant Gilmore discusses postwar changes and development in air freight business, industrial finance, distribution systems, mail order houses, and industrial organization:

In the present post-war period, following ten years of unprecedented expansion of the national productive capacity, industrial and commercial practices are fluid and subject to sudden change. . . . It is easy to predict that as air freight gropes its way out of its experimental stage, new legal patterns for controlling and financing goods in transit will develop; it is less easy to say what the new patterns will be. . . . Industrial finance, particularly in the acquisition of short term working capital, has greatly changed during the past ten years; it is difficult to say whether the change was a temporary war-production phenomenon or the beginning of a permanent shift in our financing habits. . . . It is entirely possible that our distribution system is also undergoing significant change. Cooperative associations of producers, retailers and to a lesser extent consumers, are increasingly cutting the middleman's profit from the cost of marketing. National and regional mail order houses and chain stores have the same effect. The integrated operation, with centralized control which may extend from the extraction of raw materials to the retail distribution of finished products, may become typical of the next stage of industrial organization. . . . [I]ncrease in the range and complexity of goods and services put on the market will undoubtedly lead to far-reaching changes in our thinking about sellers' [sic] obligations.

*Id.*; see also TWINING, *supra* note 6, at 305 (stating that "the Code was drafted in the expectation that it would probably have to last without major alterations for a substantial period . . . with the prospect of an increasing momentum in the rate of technological and other change").

<sup>86</sup> See Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605 (1981).

This commercial paper [18th century mercantile bills of exchange and bank notes] typically passed from hand to hand in a long series of transfers, ending up in the hands of strangers who knew nothing about the

into the statutory and common law world of the early 1960s fits less well now. Where the Code was once the primary place to vindicate individual consumer rights, for instance, there is now a panoply of consumer protection laws.<sup>87</sup> While section 2-207 was once necessary to confirm that agreement means “bargain,” and that actions do in fact speak louder than words, we have come to appreciate the vacuity of a “last shot” rule.<sup>88</sup>

### B. Predecessor Law

Karl Llewellyn understood the commercial law the way that Lord Mansfield<sup>89</sup> and Benjamin Cardozo<sup>90</sup> understood the law generally.

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original transaction or about earlier transfers of the bill or note and had no way of finding out about them. The need to protect the strangers who bought the paper in the market, even at the cost of doing harm to the obligors and earlier holders, was the compelling reason that led the courts to elaborate the good faith purchaser, or holder in due course, idea in negotiable instruments law.

*Id.* at 612-13 (footnote omitted). The most outrageous thing about article 3, a statute drafted in the 1940s, is that there is no reference, in text or comment, to the then rapidly developing body of case law holding that finance companies and banks to which consumer notes were negotiated could not hold the notes free of the consumer’s contract defenses because of their close connection with the dealer-sellers. *See id.* at 619; *see also* Karl N. Llewellyn, *On Warranty of Quality, and Society: II*, 37 COLUM. L. REV. 341, 404-09 (1937) (describing increasing availability of “tort-like” damages to “helpless” consumers who bring claims against manufacturers to recover for injuries sustained due to defective products).

<sup>87</sup> *See, e.g.*, Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691f (1998) (prohibiting discrimination in credit transactions); Fair Credit Reporting Act, 15 U.S.C. §§ 1681-1681t (1998) (requiring credit reporting agencies to use fair and equitable procedures); Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692m (1998) (preventing abusive debt collection); Magnuson-Moss Consumer Warranty Act, 15 U.S.C. §§ 2301-2312 (1998) (promoting clear and comprehensive warranties for consumer products); Truth in Lending Act, 15 U.S.C. §§ 1601-1667f (1998) (promoting consumers access to credit terms); FTC Trade Regulation Rule Concerning Cooling-Off Period for Sales Made at Homes or at Certain Other Locations, 16 C.F.R. § 429 (1998) (providing consumers with option to cancel sale); Consumer Reporting Agency Act, MASS. GEN. LAWS ANN. ch. 93, §§ 50-68 (Law. Co-op. 1985 & Supp. 1994) (regulating consumer credit reports); Credit Services Act, MICH. COMP. LAWS ANN. § 445.1701-1708 (West Supp. 1994); Retail Installment Sales Act, N.J. STAT. ANN. § 17:16C-27 (West 1984) (setting provisions for retail installment sales); *see also* MICHAEL M. GREENFIELD, *CONSUMER LAW: A GUIDE FOR THOSE WHO REPRESENT SELLERS, LENDERS, AND CONSUMERS* 1-6 (1995) (discussing development of consumer protection law in twentieth century).

<sup>88</sup> *See* U.C.C. § 2-207 (Discussion Draft Mar. 1, 1998) (visited Oct. 30, 1998) <<http://www.law.upenn.edu/library/ulc/ulc2/ucc2298.htm>> (on file with author) (discussing section 2-207 “Road Map” to interpreting which terms are in contract formed under article 2).

<sup>89</sup> *See* *Miller v. Race*, 97 Eng. Rep. 398, 401-02 (K.B. 1758) (Mansfield, J.) (outlining holder in due course doctrine).

<sup>90</sup> *See* BENJAMIN N. CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 149-52 (1921). Cardozo believed, for example, that adherence to precedent should be relaxed when a rule

That is, Llewellyn appreciated that for the enacted and codified commercial law to be vital, for it to really matter in commercial transactions, it must be considerate of its antecedents.<sup>91</sup> Just as it would not make good sense to draft commercial law without regard to the way businesspeople do business,<sup>92</sup> it would be shortsighted, and ultimately ineffective, to draft comprehensive and preemptive commercial legislation<sup>93</sup> without regard to the evolving and evolved commercial contracting principles.

This point, applied to the current effort to revise article 2, is so simple that it might go unappreciated: the lawyers drafting the revision must understand and appreciate the current article 2 law. This type of appreciation is not gleaned merely from a familiarity with the cases, but from a sense of the problematic language in the current formulations of the law. To appreciate the current law is to understand how it works "warts and all" and to recognize that even the adjustment that merely "cleans up" problematic language comes with a cost: the cost of courts and litigants coming to terms with new terms, that might, in the fullness of time, manifest a new and perhaps more intractable set of problems. The drafters must start with a respect for the law that they are revising; all presump-

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that "has been duly tested by experience, has been found to be inconsistent with the sense of justice or with the social welfare." *Id.* at 150. Commenting on the judicial role with respect to the development of the common law, Cardozo stated: "If judges have woefully misinterpreted the *mores* of their day, or if the *mores* of their day are no longer those of ours, they ought not to tie, in helpless submission, the hands of their successors." *Id.* at 152.

<sup>91</sup> See Llewellyn, *supra* note 86, at 409 (concluding it is better to let policy be rebuilt as facts change rather than enacting statutes which are quickly outdated).

<sup>92</sup> See, e.g., TWINING, *supra* note 6, at 304-05 (noting that UCC's drafters treated businesspeople as Code's "principal addressees"); Gilmore, *supra* note 85, at 1341 (asserting that draftsmen of commercial law attempted to state as matter of law meaning that business community gives to transaction).

<sup>93</sup> See Hawkland, *supra* note 22, at 291-92.

[T]here is a vast difference between a "code" and a "statute". . . . A "code" is a pre-emptive, systematic, and comprehensive enactment of a whole field of law. It is pre-emptive in that it displaces all other law in its subject area save only that which the code excepts. It is systematic in that all of its parts, arranged in an orderly fashion and stated with a consistent terminology, form an interlocking, integrated body, revealing its own plan and containing its own methodology. It is comprehensive in that it is sufficiently inclusive and independent to enable it to be administered in accordance with its own basic policies.

. . . .

. . . . A mere statute, on the other hand, is neither pre-emptive, systematic, nor comprehensive, and, therefore, its methodology is different from that of a code.

*Id.*



tions must be made in favor of the status quo; change for change's sake (or because a law professor on the drafting committee has always had a question about a statutory turn of phrase) is to be avoided at all costs.

Llewellyn was first a student of the law and then a drafter of it. His work on the sociological and historic antecedents of the warranty law were indispensable to his appreciation of what warranty can do, and what warranty cannot do. His formulation of the contract formation provisions of article 2,<sup>94</sup> in their aggressive disregard for consideration,<sup>95</sup> reveal an understanding of where the law had been, as well as where a statute could urge it to go. The better commercial law guides more than it compels. Drafters of revised commercial law ignore existing law at their peril.

### C. *The Warranty Example*

The warranty is the deal: insofar as a contract for sale (like any other contract) is a relatively fixed allocation of risk, and insofar as the warranty provision fixes, to a large extent, prospective (and, therefore, less predictable) risk, the warranty provision determines what it is that the seller is selling and the buyer is buying. To make the point more stark, we would propose that, from the perspective of the sales law, there is more affinity between the sale of a fifteen dollar electric can opener sold with a warranty and a luxury car sold with a warranty than there is between one large car sold with a warranty and another sold with no warranties. While this might border on hyperbole, it captures well our reasons for focusing on the Article 2 Drafting Committee's treatment of warranties as a means to inform critique of the article 2 revision project.

In this section of the Article we consider the foundations of warranty in terms that are pertinent to the "evolution" of warranty law

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<sup>94</sup> See U.C.C. §§ 1-103 (stating "[s]upplementary General Principles of Law Applicable"), 1-201(3) ("Agreement"), 1-201(11) ("Contract"), 1-205 ("Course of Dealing and Usage of Trade"), 2-204 ("Formation in General"), 2-205 ("Firm Offers"), 2-206 ("Offer and Acceptance in Formation of Contract"), 2-207 ("Additional Terms in Acceptance or Confirmation" ["Battle of the Forms"]), 2-208 ("Course of Performance or Practical Construction") (1998).

<sup>95</sup> Code sections 2-205 and 2-209, for example, which refer to Firm Offers and to Modification, Rescission and Waiver respectively, state that consideration is not necessary either to keep open an offer or to modify a contract. See *id.* §§ 2-205, 2-209 (1998). These sections altered the common law requirement that firm offers and modifications be supported by consideration. See WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES §§ 2-205:01, 2-209:01 (1998).

that would be effected by the revision. We demonstrate that because the drafters failed to appreciate warranty in the way Llewellyn did a proposed provision of the warranty regime is inconsiderate of the commercial "big picture" and, therefore, not responsive to the needs of contemporary commercial transactors. And what we find most disturbing is the failure of the drafters to do the necessary "homework" that would have revealed the inadequacies of the regime they propose. That is the flaw in the process that unravels the draft revision. It is a striking, and, we believe, a fatal shortcoming.

An early case, *Randall v. Newson*,<sup>96</sup> sketches the substance of warranty. After reviewing *Randall* we turn to the understanding of warranty that informed the current article 2 scheme.

### 1. *Randall v. Newson*

In this classic warranty case, the plaintiff (buyer) of a phaeton for two horses complained that the defendant (seller) had supplied a pole for the phaeton that "was so carelessly and negligently made, and of such bad and improper wood"<sup>97</sup> that the pole failed while the plaintiff was driving the phaeton and caused damage to the horses. The phaeton had originally been designed for one horse, but the plaintiff had caused the defendant to make the adjustments that would accommodate the phaeton's supporting two horses.<sup>98</sup> The lower court characterized plaintiff's claim as sounding in negligence and reasoned that as long as no negligence on the part of defendant was shown, defendant faced no liability.<sup>99</sup> The jury found for defendant, awarding plaintiff damages only in the amount of three pounds, the cost of the pole.<sup>100</sup>

Queen's Bench reformulated the issue:

[W]hat, [in the contract of sale in issue], is the implied undertaking of the seller as to the efficiency of the pole? Is it an absolute warranty that the pole shall be reasonably fit for the purpose, or is it only partially to that effect, limited to defects which might be

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<sup>96</sup> 2 Q.B.D. 102 (C.A. 1877).

<sup>97</sup> *Id.* at 103 (stating that judgment for three pounds was ordered for plaintiff upon jury's finding).

<sup>98</sup> *See id.* at 105.

<sup>99</sup> *See id.* (stating principle of merchantability and implied fitness for particular purpose of carriage support).

<sup>100</sup> *See id.*

discovered by care and skill?<sup>101</sup>

Or, in the most direct terms, is a seller's warranty liability a matter of negligence? In the course of answering that question, the court provides a thoughtful, and prescient statement of the sum and substance of the warranty undertaking:

The governing principle . . . is that the thing offered and delivered under a contract of purchase and sale must answer the description of it which is contained in words in the contract, *or which would be so contained if the contract were accurately drawn out . . .* If the article or commodity offered or delivered does not in fact answer the description of it in the contract, it does not do so more or less because the defect in it is patent, or latent, or discoverable.<sup>102</sup>

Plaintiff's appeal succeeded.<sup>103</sup> There are three pedagogical points to be gleaned from the brief excerpt from the holding: (1) the terms of the seller's warranty may be expressly stated in terms of the contract — this demonstrates the contract basis of warranty, (2) as seen in the underscored language, the warranty may be implied — this is consistent with a contract-bargain model of implied warranty,<sup>104</sup> and (3) the negligence of the seller is inapposite — however, this would seem mitigated by the fact that the seller is held to the warranty that may be implied by context.

The decision is seminal in that it captures the coalescence of what are formulated as three separate bases of warranty liability in article 2: the express warranty of section 2-313,<sup>105</sup> the implied war-

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 109 (emphasis added).

<sup>103</sup> *See id.* at 111.

<sup>104</sup> *See, e.g.,* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 834-36 (1985) (arguing that, in debtor-creditor relationship, law should provide contracting parties with rights they would bargain for if they had time and money to do it); Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702 (1982) (stating that most efficient fiduciary rules form bargains that investors and agents would arrive at if bargaining had no transactional costs); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 588 n.87 (1977) (stating that in costless environment contracts would be enforced on their terms alone, however due to transaction costs law specifies legal consequences of typical bargains).

<sup>105</sup> *See* U.C.C. § 2-313 (1998). Express Warranties by Affirmation, Promise, Description, Sample:

ranty of merchantability of section 2-314,<sup>106</sup> and the implied warranty of fitness for particular purpose in section 2-315.<sup>107</sup> These three provisions define warranty.

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- (1) Express warranties by the seller are created as follows:
    - (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
    - (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
    - (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.
  - (2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

*Id.*

<sup>106</sup> See U.C.C. § 2-314 (1998). Implied Warranty: Merchantability; Usage of Trade

- (1) Unless excluded or modified (section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.
- (2) Goods to be merchantable must be at least such as
  - (a) pass without objection in the trade under the contract description; and
  - (b) in the case of fungible goods, are of fair average quality within the description; and
  - (c) are fit for the ordinary purposes for which such goods are used; and
  - (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
  - (e) are adequately contained, packaged, and labeled as the agreement may require; and
  - (f) conform to the promises or affirmations of fact made on the container or label if any.
- (3) Unless excluded or modified (section 2-316) other implied warranties may arise from course of dealing or usage of trade.

*Id.*

<sup>107</sup> See *id.* § 2-315 (1998). Implied Warranty: Fitness for Particular Purpose

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

*Id.*

## 2. What Warranty Liability Is

Warranty under article 2 of the UCC is essentially what warranty was for Queens Bench in *Randall v. Newson*. Warranty is the product of the "illicit intercourse of tort and contract," as Prosser so colorfully put it.<sup>108</sup> It is what happens when contract risk is formulated in terms of transactor expectations; and warranty is, as well, defined by the remedy for its breach.<sup>109</sup>

Each of the principal article 2 warranties of quality, the express warranty provided by section 2-313, as well as the implied warranties of sections 2-314 ("Merchantability") and 2-315 ("Fitness for Particular Purpose") represent the combination of contract and tort principles.<sup>110</sup> While that Janus-like tension is borne out in numerous ways, the duality is starkly presented in each of the three provisions.

The express warranty section contemplates that "affirmations of fact or promises" that became "a part of the basis of the bargain" may be express warranties.<sup>111</sup> The affirmations would be express terms of the parties' contract. However, before a court can conclude that a particular representation satisfies that test, the court must be confident that the defendant-seller's representation was not "merely puffing," or "dealer's talk."<sup>112</sup> To determine whether the representation is such an affirmation or promise rather than puffing, the court will consider the transactional context and focus on the transactors' relative sophistication.<sup>113</sup>

<sup>108</sup> William L. Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1126 (1960).

<sup>109</sup> See, e.g., *Randall v. Newson*, 2 Q.B.D. 102, 111 (C.A. 1877) (stating that jury should decide both liability and damages).

<sup>110</sup> See U.C.C. §§ 2-313 to 2-315.

<sup>111</sup> *Redmac, Inc. v. Computerland of Peoria*, 489 N.E.2d 380, 382 (Ill. App. Ct. 1986) (finding no clear distinction between express warranties and mere puffing).

<sup>112</sup> See, e.g., *Pell City Wood, Inc. v. Forke Bros. Auctioneers, Inc.*, 474 So. 2d 694, 695 (Ala. 1985) (holding that auctioneer's statements that trucks were "in good condition" and "ready to work tomorrow" were clear examples of "puffing," and did not "rise to the level of an express warranty"); *Redmac*, 489 N.E.2d at 382 (stating that "[s]ales talk which relates only to the value of the goods or the seller's personal opinion or commendation of the goods is considered puffing and is not binding on the seller"); *Miller v. Lentine*, 495 A.2d 1229, 1231 (Me. 1985) (stating that "puffing" denotes "praise of goods by the seller").

<sup>113</sup> See, e.g., *Thursby v. Reynolds Metals Co.*, 466 So. 2d 245, 250 (Fla. Dist. Ct. App. 1984) (explaining that where buyer and seller have equal knowledge of facts surrounding product, seller's statement as to that product creates no express warranty); *Miller*, 495 A.2d at 1231 (stating that circumstances of agreements and relative knowledge of contracting parties are significant factors to consider in finding express warranty); *Lovington Cattle Feeders, Inc. v. Abbott Lab.*, 642 P.2d 167, 170 (N.M. 1982) (stating that "[a]ll of the circumstances of a sale are to be considered when determining whether there was an express warranty or a mere

The section 2-314 implied warranty of merchantability may arise from contractual “promises or affirmations of fact made on the container or label.”<sup>114</sup> The provision also contemplates that the court will determine whether the goods were, for example, “fit for their ordinary purposes,” or “will pass without objection in the trade.”<sup>115</sup> The court must consult general transactor expectations in order to determine whether the seller’s tender was, in fact, reasonable under the circumstances.<sup>116</sup> That reference to industry norms is explicit in subsection (3), which invokes usages of trade<sup>117</sup> to determine the sum and substance of an implied warranty of merchantability. The alternative tests of merchantability in subsection 2-314(2) are illustrative, not exhaustive.<sup>118</sup> Further, the merchantability warranty arises only when the goods in issue are sold by a “merchant,” and the section 2-104 definition of that term invokes the language of tort.<sup>119</sup>

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expression of opinion”).

<sup>114</sup> U.C.C. § 2-314(2)(f).

<sup>115</sup> *Id.* § 2-314(2)(a), (c).

<sup>116</sup> *See, e.g., Phillips v. Town of West Springfield*, 540 N.E.2d 1331, 1332 (Mass. 1989) (applying “reasonable expectations” test to determine whether consumer should have expected to find injury-causing substance in his food); *Dempsey v. Rosenthal*, 468 N.Y.S.2d 441, 445-46 (N.Y. Civ. Ct. 1983) (finding that seller of pedigree dog reasonably should assume that buyer wants to breed it).

<sup>117</sup> *See* U.C.C. § 1-205 (1998):

**Course of Dealing and Usage of Trade**

A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

*Id.*

<sup>118</sup> *See* U.C.C. § 2-314 cmt. 6. This section states:

Subsection (2) does not purport to exhaust the meaning of “merchantable” nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is “must be at least such as ...,” and the intention is to leave open other possible attributes of merchantability.

*Id.*

<sup>119</sup> *See* U.C.C. § 2-104 (1998) (stating that merchant is one “who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed”); *see also Cropper v. Rego Distribution Ctr., Inc.*, 542 F. Supp. 1142, 1153-54 (D. Del. 1982) (analyzing whether defendant was “merchant” in context of breach of implied warranty claim in personal injury action); *Ferragamo v. Massachusetts Bay Transp.*

The section 2-315 fitness for particular purpose warranty is formulated in terms that require comparison of the transactors' reasonable expectations.<sup>120</sup> The warranty only arises when the seller has reason to know that the buyer is actually relying on the seller's expertise. In such a case the seller has the duty contemplated by the implied warranty.<sup>121</sup> The seller's duty may, of course, be inferred from the incidents of the contract between buyer and seller, for instance, what each said to the other.<sup>122</sup>

A significant aspect of the Code's provision of those three bases of warranty liability is their simultaneously alternative and cumulative coincidence. The same goods in the same transaction may breach more than one of the three warranties.<sup>123</sup> In fact, the same factual predicate may support all three theories.<sup>124</sup> Keep in mind, too, that the warranty theories may cooperate with other seller liability theories, premised, for example, on negligence,<sup>125</sup> misrepresentation,

Auth., 481 N.E.2d 477, 480-82 (Mass. 1985) (discussing whether defendant qualified as merchant in wrongful death action).

<sup>120</sup> See U.C.C. § 2-315 (1998) (stating that "[w]here the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods").

<sup>121</sup> Thus, a seller's duty with respect to an implied warranty is similar to Justice Cardozo's negligence standard in *Palsgraf v. Long Island Railroad*, 162 N.E. 99, 100 (N.Y. 1928) (stating negligence standard as "[t]he risk reasonably to be perceived defines the duty to be obeyed, and risk imports relation; it is risk to another or to others within the range of apprehension").

<sup>122</sup> See, e.g., *Crawford v. Gold Kist, Inc.*, 614 F. Supp. 682, 687-88 (M.D. Fla. 1985) (illustrating that communication between contracting parties may fail to determine existence of implied warranty of fitness for particular purpose).

<sup>123</sup> See, e.g., *Pegasus Helicopters, Inc. v. United Tech. Corp.*, 35 F.3d 507, 511 (10th Cir. 1994) (holding that express warranty and implied warranty of merchantability arose from certificate of conformance which stated fuel controls were "serviceable"); *Soaper v. Hope Indus., Inc.*, 424 S.E.2d 493, 495 (S.C. 1992) (finding that because particular purpose for which product is purchased was also ordinary or intended purpose of product, warranties of merchantability and of fitness combine).

<sup>124</sup> See, e.g., *Fiberglass Component Prod., Inc. v. Riechhold Chems., Inc.*, 983 F. Supp. 948, 953-55 (D. Colo. 1997) (allowing buyer to sue for breach of express and implied warranties due to claims made by manufacturer's representative); *L.B. Trucking, Inc. v. Townsend Grain & Feed Co.*, 163 B.R. 709, 719-22 (D. Del. 1994) (holding that breach of both express and implied warranties arose from statements regarding effectiveness of herbicides and actual application process); *Crest Container Corp. v. R.H. Bishop Co.*, 445 N.E.2d 19, 23-24 (Ill. App. Ct. 1982) (allowing buyer of coil heating units to sue for breach of merchantability, express warranty, and implied warranty of fitness).

<sup>125</sup> See, e.g., *Lim Enters. v. Sears, Roebuck & Co.*, 912 F. Supp. 478, 479 (D. Kan. 1996) (holding that facts would support claim under tort or contract law); *Keaton v. A.B.C. Drug Co.*, 467 S.E.2d 558, 561-62 (Ga. 1996) (stating that failure to adequately package bleach allowed claims of negligence and breach of implied warranty of merchantability); cf. *Lagalo v. Allied Corp.*, 554 N.W.2d 352, 354 (Mich. Ct. App. 1996) *rev'd on other grounds*, 577 N.W.2d 462 (1998) (stating that plaintiff could bring suit under both negligence and implied warranty theories).

sensation,<sup>126</sup> and strict products liability.<sup>127</sup>

Appreciating the article 2 warranty provisions as, to varying degrees perhaps, the coincidence of contract and tort requires some extended consideration of the contract and tort characteristics of warranty liability. Once these characteristics are understood we may come to terms with the deficiencies of the proposed revision.

#### a. Contracts

The part of warranty most redolent of contract is the privity requirement.<sup>128</sup> Insofar as contractual relations are, at least in theory, consensual, the fundamental premise is that there be something like a meeting of the minds between contracting parties. Notions of privity are consistent with that predisposition. The privity element of warranty was crucial to the development of sections 2-313, 2-314, and 2-315 of the UCC. Each of these sections responded to the problem of deficient goods that fail, and, in failing, occasionally hurt people.

There are two kinds of privity in the warranty law: vertical privity — privity from one level of the distributive chain to the next; and horizontal privity — privity among those at the same level of distribution.<sup>129</sup> The fact that privity is a requisite for the maintenance of

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<sup>126</sup> See, e.g., *Mainline Tractor & Equip. Co. v. Nutrite Corp.*, 937 F. Supp. 1095, 1104-08 (D. Vt. 1996) (allowing claim for negligent misrepresentation and breach of express warranty); *IHP Indus., Inc. v. PermAlert*, 947 F. Supp. 257, 261 (S.D. Miss. 1996) (allowing claims for fraudulent misrepresentation and implied warranty from statement by seller's employee that pipes could withstand pressure); *Cox v. Lewiston Grain Growers, Inc.*, 936 P.2d 1191, 1198-99 (Wash. Ct. App. 1997) (stating that claims for misrepresentation and breach of express warranty arose from statements about seed quality).

<sup>127</sup> See, e.g., *Miles v. Ford Motor Co.*, 922 S.W.2d 572, 583-86 (Tex. Ct. App. 1996) (stating that jury could have found defects in design, manufacturing, and marketing of seatbelt); cf. *Commonwealth v. Johnson Insulation*, 682 N.E.2d 1323, 1326-27 (Mass. 1997) (equating breach of implied warranty of merchantability with sale of "unreasonably dangerous" item under § 402A of Restatement for failure to warn); *Mendel v. Pittsburgh Plate Glass Co.*, 253 N.E.2d 207, 210 (N.Y. 1969) (observing "strict liability in tort and implied warranty in absence of privity are merely different ways of describing the very same cause of action").

<sup>128</sup> See 2 JOSEPH M. PERILLO & HELEN H. BENDER, *CORBIN ON CONTRACTS* § 5.11, at 54-55 (ed. rev. 1995).

<sup>129</sup> See *Salvador v. Atlantic Steel Boiler Co.*, 319 A.2d 903, 904 n.1 (Pa. 1974). The court states the following in this case:

The "vertical" privity chain begins at the retailer and continues through any number of levels to the manufacturer of the defective product. The question of vertical privity is "who can be sued"? The question of horizontal privity is "who can sue"? The purchaser can sue the retail seller because they are in privity. When the requirement of vertical privity has been abolished, he may also sue any other entity in the distributive



a warranty action was one reason for the development of strict products liability. Strict products liability provides the means to impose liability on the manufacturer of a defective product irrespective of the existence of privity.<sup>130</sup> Thus, in strict products liability, a direct contract relation, between the plaintiff-buyer and defendant-seller, need not be found.<sup>131</sup>

Article 2 of the UCC includes section 2-318, which concerns "Third Party Beneficiaries" of the Code's express and implied warranties.<sup>132</sup> There are three iterations of the third party beneficiary provision. Alternative A,<sup>133</sup> the first formulation, was promulgated as part of original article 2;<sup>134</sup> this was a time when the development of products liability theories was embryonic.<sup>135</sup> Alternative A is the most restrictive, limiting the seller's warranty liability to the buyer and those in the buyer's household. Alternatives B and C are each more expansive, exposing the seller to more liability and to more potential plaintiffs.<sup>136</sup>

chain.

*Id.*

<sup>130</sup> See W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS, § 98, at 692 (5th ed. 1984).

<sup>131</sup> See *id.*

<sup>132</sup> See U.C.C. § 2-318 (1998).

<sup>133</sup> See *id.* Third Party Beneficiaries of Warranties Express or Implied.

#### Alternative A

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

*Id.*

<sup>134</sup> See HAWKLAND, *supra* note 95, at 678 (observing that when first official Code was promulgated in 1952, section 2-318 was identical to present Alternative A).

<sup>135</sup> See KEETON ET AL., *supra* note 130, at 693 (stating that "those who drafted the Uniform Commercial Code did so at a point in time when a tort theory was not openly recognized as such"). See generally William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791, 791-848 (1966) [hereinafter Prosser, *The Fall of the Citadel*] (examining revolutionary changes in product liability).

<sup>136</sup> See U.C.C. § 2-318. Third Party Beneficiaries of Warranties Express or Implied which states in part:

#### Alternative B

A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Each of the three alternatives of section 2-318 concern only horizontal privity. None has anything to say about vertical privity, the consumer's right to proceed directly against the manufacturer who sold goods in breach of an express or implied warranty.<sup>137</sup>

A leading case, *Henningsen v. Bloomfield Motors, Inc.*,<sup>138</sup> decided in 1960, when the fit between strict products liability and warranty was being forged, recognized the limited utility of a privity analysis in the warranty law:

The limitations of privity in contracts for the sale of goods developed their place in the law when marketing conditions were simple, when maker and buyer frequently met face to face on an equal bargaining plane and when many of the products were relatively uncomplicated and conducive to inspection by a buyer competent to evaluate their quality. . . . With the advent of mass marketing, the manufacturer became remote from the purchaser, sales were accomplished through intermediaries, and the demand for the product was created by the advertising media.

. . .

Although only a minority of jurisdictions have thus far departed from the requirement of privity, the movement in that direction is most certainly gathering momentum. Liability to the ultimate

#### Alternative C

A seller's warranty whether express or implied extends to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends.

*Id.*

<sup>137</sup> Several courts, however, distinguish between express and implied warranties in their analyses of whether lack of privity can stand as a bar to recovery. *See, e.g., Collins Co. v. Carboline Co.*, 532 N.E.2d 834, 838 (Ill. 1988) (discussing that express warranty is implied by contract but implied warranty is imposed by law); *Copiers Typewriters Calculators, Inc. v. Toshiba Corp.*, 576 F. Supp. 312, 323 (D. Md. 1983) (holding that vertical privity is not required for recovery for breach of implied warranty); *Dravo Equip. Co. v. German*, 698 P.2d 63, 65 (Or. Ct. App. 1985) (stating that express warranties should extend to remote purchasers, but implied warranties should not extend beyond original transaction).

<sup>138</sup> 161 A.2d 69, 97 (N.J. 1960) (holding that disclaimer of implied warranty of merchantability should be invalidated as against public welfare). *Bloomfield Motors*, a Plymouth dealer, sold a car to Claude Henningsen, who communicated to the dealer his intention to give the car to his wife. *See id.* at 73. A couple of weeks later, as Mrs. Henningsen was driving the car, a sudden mechanical failure caused her to lose control of the automobile, resulting in an accident in which she was injured and the car badly damaged. *See id.* at 75. The Henningsens sued the dealer and the manufacturer under negligence and breach of warranty theories. *See id.* at 73. The court held the manufacturer could be held liable although privity of contract was not shown. *See id.* at 83-84.

consumer in the absence of direct contractual connection has been predicated upon a variety of theories. Some courts hold that the warranty runs with the article like a covenant running with land; others recognize a third-party beneficiary thesis; still others rest their decision on the ground that public policy requires recognition of a warranty made directly to the consumer.<sup>139</sup>

While *Henningsen* was certainly one of the more articulate statements of the evolving view toward privity in warranty actions,<sup>140</sup> it was not unique. The next section of this Article reviews a decision where the court appreciated the relationship between warranty theory and the strict products liability law, in terms that ultimately reveal the incongruity of the Article 2 Drafting Committee's formulation of the sales warranties.

#### b. Tort

The Supreme Court of Pennsylvania, in *Salvador v. Atlantic Steel Boiler Co.*,<sup>141</sup> held that plaintiff's lack of horizontal privity with the defendant manufacturer did not bar plaintiff's suit for damages. This holding came after the State had abrogated the necessity of vertical privity in warranty cases<sup>142</sup> in recognition of strict liability theory.<sup>143</sup> The court concluded that the significant development of the products liability law had rendered the privity conception impotent in the warranty law: because privity does not matter under section 402A of the Restatement of the Law (Second) Torts,<sup>144</sup> it

<sup>139</sup> *Id.* at 81-82.

<sup>140</sup> See Prosser, *The Fall of the Citadel*, *supra* note 135, at 793.

<sup>141</sup> 319 A.2d 903 (Pa. 1974).

<sup>142</sup> See *Kassab v. Central Soya*, 246 A.2d 848, 855-56 (Pa. 1968) (addressing breach of warranty in action involving misrepresentations about drugs included in cattle feed mixture).

<sup>143</sup> See *Webb v. Zern*, 220 A.2d 853, 854-55 (Pa. 1966) (holding plaintiff was allowed to amend complaint to include theory of strict liability for exploding beer keg).

<sup>144</sup> RESTATEMENT (SECOND) OF TORTS: SPECIAL LIABILITY OF SELLER OF PRODUCT FOR PHYSICAL HARM TO USER OR CONSUMER § 402A (1965). This section reads:

- (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if
  - (a) the seller is engaged in the business of selling such a product, and
  - (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.
- (2) The rule stated in subsection (1) applies although

would be nonsensical for it to matter in the warranty law. The Pennsylvania Supreme Court recounted its conclusion in an earlier case abrogating any vertical privity requirement:

Under the Uniform Commercial Code, once a breach of warranty has been shown, the defendant's liability, assuming of course the presence of proximate cause and damages, is absolute. Lack of negligence on the seller's part is no defense. Therefore, prior to the adoption of 402a, it could be said that to dispense with privity would be to allow recovery in contract without proof of negligence, while requiring a showing of negligence in order to recover for the same wrong against the same defendant if suit were brought in tort. *To permit the result of a lawsuit to depend solely on the caption atop plaintiff's complaint is not now, and has never been, a sound resolution of identical controversies.*<sup>145</sup>

That observation, relating to the privity issues, is fundamental to a critique of the products liability law and revised article 2 warranty scheme. It also reveals the incongruity that would emerge from the Drafting Committee's failure to appreciate the warranty law as it would become under the revision.

Insofar as the UCC warranties are, at least in some measure, the product of tort principles,<sup>146</sup> it is not particularly disquieting that privity conceptions should be abandoned either by the statute or by the courts' construction of the statute.<sup>147</sup> Our issue with the revision's warranty provisions is not with the death of privity, it is with the Committee's failure to appreciate the consequences of their reformulation of the warranty law for the fit between a revised article 2 and the complementary law.

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- (a) the seller has exercised all possible care in the preparation and sale of his product, and
  - (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

*Id.*

<sup>145</sup> *Kassab*, 246 A.2d at 853 (emphasis added).

<sup>146</sup> See Prosser, *The Fall of the Citadel*, *supra* note 135, at 800-01 (explaining influence of tort law on Sales Act and UCC).

<sup>147</sup> See *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 100 (N.J. 1960) (stating that "awareness" of evolution of warranty from tort makes accepting relaxing privity concepts easier).

### 3. What Warranty Would Become

At the time current article 2 was promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institute ("ALI"), the law of products liability was in flux. The drafters of the Code recognized that the warranty provisions would have to fit with established commercial practice and not undermine the development of complementary bodies of law. Further, the current Code's warranty provisions were consistent with the law governing the quality of goods as it had evolved up to the time of the Code's promulgation.<sup>148</sup> Finally, the Code, when first enacted, was supposed to be a "Code."<sup>149</sup> That is, the drafters were sensitive to the need for consistency from one article to the next. While there may not be perfect symmetry, the instances of conflict do not undermine the whole.

The Drafting Committee's revision of article 2's warranty provisions does not compare favorably with the current law. The draft is inconsiderate of the complementary sources of law and fails to appreciate the balance struck by the predecessor law.

Strict products liability is, largely, a response to the deficiencies of the application of negligence and warranty principles to the problem of products that hurt people. If an injured buyer of a good sues the defendant manufacturer in negligence, the buyer must establish that the manufacturer breached a duty to the buyer. Establishing the elements of that negligence action is, at best, expensive and problematic,<sup>150</sup> and, in any event, would often frustrate public policy.<sup>151</sup> A manufacturer who puts a dangerous product in the stream of commerce should bear the costs of accidents caused by that product.<sup>152</sup> Whether one is sympathetic to that view, if

<sup>148</sup> See generally Karl N. Llewellyn, *On Warranty of Quality, and Society*, 36 COLUM. L. REV. 699, 701-08 (1936) (examining common law birth and development of warranty of quality).

<sup>149</sup> Code is defined as "a systematic collection, compendium or revision of laws, rules, or regulations." BLACK'S LAW DICTIONARY 257 (6th ed. 1990).

<sup>150</sup> See, e.g., *Escola v. Coca Cola Bottling Co.*, 150 P.2d 436, 438-40 (Cal. 1944) (describing and examining, in context of *res ipsa loquitur*, chain of control over soda bottle prior to its explosion in plaintiff's hand).

<sup>151</sup> See *id.* at 440-41 (Traynor, J., concurring) (endorsing strict liability for manufacturers because of their unique ability to prevent harm to consumers).

<sup>152</sup> Under this regime, the costs of accidents caused by defective products do not fall upon the injured, "who are powerless to protect themselves." *Greenman v. Yuba Power Prods., Inc.*, 377 P.2d 897, 901 (Cal. 1962) (finding strict liability for manufacture design defects of power tool).

manufacturer liability is the goal, negligence theory is a rough way to get there.

Just as the tort negligence theory might leave something to be desired, the contract/tort warranty theory alone may be deficient. In order to prevail in a warranty action, and assuming that the plaintiff-buyer can establish that a warranty arose in the transaction, the plaintiff-buyer must establish three things: (1) that the warranty has not been effectively disclaimed, (2) that the buyer is in privity with the defendant-seller, and (3) that the plaintiff-buyer provided the defendant-seller notice of the breach of warranty.<sup>153</sup> Those requisites, just as the elements of a negligence action, may not serve a greater societal interest in holding manufacturer's liable for the injuries caused by their products.

It is in the breach between the negligence and warranty law that strict products liability takes purchase.

In the early 1960s, American courts began to recognize that a commercial seller of any product having a manufacturing defect should be liable in tort for harm caused by the defect regardless of the plaintiff's ability to maintain a traditional negligence or warranty action. Liability attached even if the manufacturer's quality control in producing the defective product was reasonable. A plaintiff was not required to be in direct privity with the defendant seller to bring an action. Strict liability in tort for defectively manufactured products, merges the concept of implied warranty, in which negligence is not required, with the tort concept of negligence, in which contractual privity is not required.<sup>154</sup>

So any reformulation of warranty theory in a revised article 2 *must* be considerate of the development of strict products liability law. The reformulation of warranty law under revised article 2 would enhance the ability of those personally injured to recover damages based on breach of warranty as the warranties are defined by article 2. However, if the products law has evolved to the point where it responds to socioeconomic problems that were once the sole prov-

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<sup>153</sup> See *id.* at 899-900.

<sup>154</sup> RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 1 cmt. a (Proposed Final Draft, Apr. 1, 1997); see also *id.* at § 2(a) (stating that "[a] product . . . contains a manufacturing defect when the product departs from its intended design even though all possible care was exercised in the preparation and marketing of the product").

ince of warranty and negligence law, then warranty need not cover the same ground in terms that might assure different results in legally identical cases: "To permit the result of a lawsuit to depend solely on the caption atop plaintiff's complaint is not now, and has never been, a sound resolution of identical controversies."<sup>155</sup>

The members of the Article 2 Drafting Committee have so ignored the legal context into which they would inject a new conception of product warranties that, in fact, legal results would change depending upon "the caption atop plaintiff's complaint" under the proposed law.<sup>156</sup> While the coexistence of the implied warranty of merchantability, negligence, and strict products liability doctrine could continue to make sense under a revised sales law, the coordination of the merchantability warranty and strict products liability law must assure that distinctions among the causes of action retain substance. Otherwise, there is no reason for the law to recognize alternatives that might confound transactor expectations and yield uncommercial results.

Members of the Article 2 Drafting Committee are cognizant of the tension between the implied warranty of merchantability and strict products liability theories in the personal injury law. To make clear that the tests for merchantability and defectiveness would be consistent with one another, the Committee decided to describe the merchantability/defect relationship in a note rather than in the black letter:<sup>157</sup>

When recovery is sought for injury to person or property that allegedly resulted from manufacturing or design defects in goods sold or inadequate warnings, the applicable state law of products liability determines whether the goods are merchantable under Section 2-404 [the Implied Warranty of Merchantability provision]. Merchantability in the context of a claim to recover for injury to person or property is synonymous with the level of safety required for the goods as a matter of public policy adopted by the courts of this state or, if applicable, the restatement of the Law

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<sup>155</sup> *Kassab v. Central Soya*, 246 A.2d 848, 853 (Pa. 1968) (discussing financially sophisticated manufacturers escaping liability due to no privity of contract).

<sup>156</sup> *See id.* (discussing that warranties should not run only to middleman retailers, but also to ultimate consumers).

<sup>157</sup> *See* U.C.C. § 2-404, note 4 (Tentative Draft, Mar. 1, 1998); *see also* Alces & Frisch, *supra* note 4, at 436-41, 447-57 (discussing purposes and consequences of producing comments to Code, which allows drafters to "state the reasons and arguments for their decisions").

(Third), Torts: Products Liability.

When, however, the claim for injury to person or property is based on an implied warranty of fitness [for Particular Purpose] under Section 2-405<sup>158</sup> or representations made by the seller to the buyer, such as affirmations or promises about or descriptions of the goods, this Article determines whether an implied warranty of fitness was made or breached and whether the promises, affirmations or descriptions create contractual warranties to which the goods must conform,<sup>159</sup> as well as the remedies available for

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<sup>158</sup> See U.C.C. § 2-405 (Tentative Draft, Mar. 1, 1998). This section states:

Subject to section 2-406, if a seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is an implied warranty that the goods are fit for that purpose.

*Id.*

<sup>159</sup> See U.C.C. § 2-408 (Tentative Draft, Mar. 1, 1998).

Extension of Express Warranty to Remote Buyer and Transferee.

- (a) In this section, "goods" means new goods and goods that are sold as new goods.
- (b) If a seller makes a representation or a promise relating to goods on or in a container, on a label, in a record, or that is otherwise packaged with or accompanies the goods and authorizes another person to furnish the representation or promise to a remote buyer and it is so furnished, the seller has an obligation to the remote buyer and its transferee, and in the case of a remote consumer buyer, to any member of the family or household of the remote consumer buyer or a guest in the house of the remote consumer buyer, that the goods will conform to the representation or that the promise will be performed, unless a reasonable person in the position of the remote buyer would not believe the representation or promise or would believe that any representation was merely of the value of the goods or purported to be merely the seller's opinion or commendation of the goods.
- (c) If a seller makes a representation or a promise relating to the goods in a medium for communication to the public, including advertising, and a remote buyer with knowledge of the representation or promise buys or leases the goods from a person [in the normal chain of distribution] the seller has an obligation to the remote buyer and, in the case of a remote consumer buyer, to any member of the family or household of the remote consumer buyer or a guest in the home of the remote consumer buyer, that the goods will conform to the representation, or that the promise will be performed,

Alternative A [current draft]

unless a reasonable person in the position of the remote buyer would not believe the representation or promise or would believe that the representation was merely of the value of the goods or purported to be merely the seller's opinion or commendation of the goods.



damage proximately resulting from any nonconformity.<sup>160</sup>

The membership of the ALI, at its May, 1997 Annual Meeting, where the Draft Revision was presented, adopted the following language in substitute for the comment proposed by the drafters and reproduced above: "When recovery is sought for injury to person or property, whether goods are merchantable is to be determined by applicable state products liability law."<sup>161</sup> In response to that ALI action, the Reporters of the Article 2 Drafting Committee state that "[w]hatever the intent, there clearly was no intention to preclude actions for injury to person or property under sections 2-405 or 2-403 and 2-408."<sup>162</sup>

Alternative B

unless the remote buyer does not believe the representation or promise or a reasonable person in the position of the remote buyer would not believe the representation or promise or would believe that the representation was merely of the seller's opinion or commendation of the goods.

- (d) An obligation may be created under this section even though the seller does not use formal words, such as "warranty" or "guaranty."
- (e) An obligation arising under this section is breached when the goods are received by the remote buyer if the goods, at the time they left the seller's control, did not conform to any representation made, or if the promise is not performed when due.
- (f) The following rules apply to the remedies for breach of an obligation created under this section:
  - (1) A seller under subsections (b) and (c) may modify or limit the remedies available to a remote buyer for breach, but a modification or limitation is not effective unless it is communicated to the remote buyer with the representation or promise.
  - (2) Damages may be proved in any manner that is reasonable. Unless special circumstances show proximate damages of a different amount;
    - (A) the measure of damages if the goods do not conform to a representation is the value of the goods as represented less the value of the goods as delivered; and
    - (B) the measure of damages for breach of a promise is the value of the promised performance less the value of any performance made.
  - (3) Absent a modification or limitation of remedy, a seller in breach under this section is liable for incidental or consequential damages under sections 2-805 and 2-806, but is not liable for consequential damages for a remote buyer's lost profits;
  - (4) An action for breach of an obligation under this section accrues for purposes of sections 2-814 when the obligation is breached as provided in subsection (e).
- (g) This section is subject to Section 2-409(b).

*Id.*

<sup>160</sup> U.C.C. § 2-404, note 4 (Tentative Draft, Mar. 1, 1998).

<sup>161</sup> 20 A.L.I. REP. 4 (Fall 1997).

<sup>162</sup> U.C.C. § 2-404, note 4 (Tentative Draft, Mar. 1, 1998).

The Drafting Committee may well be correct that the ALI reported its actions erroneously and will take action to make clear that nothing in the strict products liability law preempts the express warranty and implied warranty of fitness for particular purpose provisions. But it is not so clear that there is reason to maintain an article 2 warranty cause of action for personal injury.<sup>163</sup> The strict products liability law, as noted above, was a response to the deficiencies of warranty theory so far as personal injury is concerned.<sup>164</sup> Now that strict products liability theory has evolved, the deficiencies of the warranty law are obviated so far as personal injury is concerned and a revised article 2 could be limited in scope to economic loss.<sup>165</sup>

Most troubling, if members of the Drafting Committee are right and breach of an express warranty or implied warranty of fitness for particular purpose can provide recovery for personal injury even when the goods in question are not defective, is the fact that the line between the implied warranty of merchantability, on the one hand, and the implied warranty of fitness for particular purpose and express warranty, on the other, is so blurred as to be essentially indistinct. For goods to be merchantable, they must at least

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

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<sup>163</sup> At the 1996 Annual Meeting of the National Conference of Commissioners on Uniform State Laws, Commissioner King Hill moved to exclude from the draft article 2 revision recovery for personal injury and property damage under warranty claims. *Id.*

<sup>164</sup> See *supra* text accompanying notes 155-59.

<sup>165</sup> Although five states currently do not recognize a cause of action in strict products liability, it is not the task of the drafters of uniform law to provide such law for these states. Delaware, Massachusetts, Michigan, North Carolina, and Virginia may not want such recovery for personal injury. Alternatively, these states can always make the necessary adjustments in a revised article 2 to meet their particular needs and policy goals.

container or label if any.<sup>166</sup>

The italicized language confirms the affinity between the implied warranty of merchantability and the express warranties under the revision. Express warranties, under the revision, arise when “a seller makes a representation or a promise relating to the goods” (1) “to an immediate buyer,”<sup>167</sup> (2) “on or in a container, on a label, in a record, or that is otherwise packaged with or accompanies the goods,”<sup>168</sup> or (3) “makes a representation or a promise relating to the goods in a medium for communication to the public, including advertising.”<sup>169</sup>

It is now very difficult to imagine an implied warranty of merchantability that could not also be, simultaneously, construed as an express warranty. So it may rarely be necessary to determine “merchantability” by reference to the state products liability law because the express warranty law may in so many cases be used in place of the implied warranty of merchantability. It would simply be too easy to infer an express warranty from the “description” or “agreement” that supports the implied warranty of merchantability, thereby paving the way for courts to impose liability for personal injuries caused by products that are not defective under the state’s products liability law. Further, lest there be any suggestion that express warranty could not devour the implied warranty of merchantability completely, keep in mind that a good’s “ordinary” purpose may also be its “particular purpose” in order to implicate the implied warranty of fitness for particular purpose in the event an implied warranty of merchantability theory is unavailable.<sup>170</sup>

It may be that the overlap among those alternative warranty theories is a necessary consequence of the commercial law’s erring on the side of comprehensive warranty coverage. Indeed, the overlap provides a means for an injured buyer to recover against a retail seller for affirmations on a label affixed by the wholesaler.<sup>171</sup>

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<sup>166</sup> U.C.C. § 2-404 (Tentative Draft, Mar. 1, 1998) (emphasis added).

<sup>167</sup> *Id.* § 2-403(a) (Tentative Draft, Mar. 1, 1998).

<sup>168</sup> *Id.* § 2-408(b) (Tentative Draft, Mar. 1, 1998).

<sup>169</sup> *Id.* § 2-408(c) (Tentative Draft, Mar. 1, 1998).

<sup>170</sup> This could be the case, under current law, if there was a proper disclaimer of the warranty of merchantability but not of the warranty of fitness for a particular purpose, or vice-versa.

<sup>171</sup> For instance, a retailer is not automatically liable under section 2-313 for a manufacturer’s express warranties; the retailer may be liable, however, for breach of an implied warranty of merchantability under section 2-314(2)(f) if a product fails to conform to a

And that circumstance has not done violence to the commercial law. But when the redundancy provides the means to impose liability for the same public policy reasons that the strict products liability law vindicates without reference to the limitations of that law, particularly the limitation imposed by the "defect" requirement, then the warranty law may well unravel. Consequently, the arguments in favor of excepting personal injury from article 2 may become all the more compelling.

The problem remains that the members of the Article 2 Drafting Committee have not yet made the case for accommodation of warranty and strict products law that their reformulation of the sales law would accomplish. The Committee has failed to come to terms with a warranty regime that would operate without respect to privity requirements<sup>172</sup> and which would, essentially, fuse the bases of

manufacturer's promise on the label. See DAVID S. FISCHER & WILLIAM POWERS, JR., PRODUCTS LIABILITY 68 n.1 (1994) (notes following *Scovil v. Chilcoat*, 424 P.2d 87, 91 (Okla. 1967)) (noting that retailer may adopt manufacturer's written warranty by statement of promises or actions).

<sup>172</sup> The revisions completely abrogate horizontal privity defenses by means of draft sections 2-403, 2-408, and 2-409. Draft section 2-403(c) explains how an express warranty can be created: "[a] seller's obligation under this section may be created by representations and promises made in a medium for communication to the public, including advertising, if the immediate buyer had knowledge of [and believed] them at the time of the agreement." U.C.C. § 2-403(c) (Tentative Draft, Mar. 1, 1998). Draft section 2-408(b) extends an express warranty to a remote buyer through a seller's written representation:

If a seller makes a representation or a promise relating to goods on or in a container, on a label, in a record, or that is otherwise packaged with or accompanies the goods . . . the seller has an obligation to the remote buyer and its transferee . . . that the goods will conform to the representation or that the promise will be performed, unless a reasonable person in the position of the remote buyer would not believe the representation or promise or would believe that any representation was merely of the value of the goods or purported to be merely the seller's opinion or commendation of the goods.

*Id.* § 2-408(b) (Tentative Draft, Mar. 1, 1998). Draft section 2-408(c) extends an express warranty to a remote buyer through a seller's public communication:

If a seller makes a representation or a promise relating to the goods in a medium for communication to the public, including advertising, and a remote buyer with knowledge of the representation or promise buys or leases the goods from a person [in the normal chain of distribution] the seller has an obligation to the remote buyer . . . that the goods will conform to the representation, or that the promise will be performed.

*Id.* § 2-408(c). In both sections 2-408(b) and (c), an express warranty also is extended horizontally to the family or household of a remote consumer buyer, including a guest in the remote buyer's home.

Finally, Draft section 2-409(a) stipulates that implied warranties also can be extended

express and implied warranty liability. It may be that warranty as we know it, as the drafters of prestrict products liability law article 2 knew it, does not work in the contemporary legal environment. The Committee, to date, has not conducted or consulted a comprehensive study of the fit among the complementary bases of seller liability for products that hurt people. That failure is enough to undermine the entire article 2 revision effort.

#### IV. ABSENCE OF INFORMATION

The substantive rules of article 2 are intended to serve certain social purposes. The most prominent among these is to facilitate the orderly buying and selling of goods.<sup>173</sup> To devise rules that will accomplish this goal, it is essential that rule makers have a reasonably accurate understanding of how the system (broadly conceived) works.<sup>174</sup> This demands accurate knowledge not only of the

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to a remote buyer:

A seller's express or implied warranty made to an immediate buyer extends to any remote buyer or transferee, and in the case of any consumer buyer, to any member of the family or household of the consumer buyer, that may reasonably be expected to use or be affected by the goods and that is damaged by a breach of warranty.

*Id.* § 2-409(a) (Tentative Draft, Mar. 1, 1998).

<sup>173</sup> In addition to this practical end, it has been said that any commercial code should be designed to achieve the following objectives: certainty and uniformity, conformity to common expectations, individual autonomy, individual and group responsibility, equality through the reversibility of relations, and justice. See 1 N.Y. COMM'N REPORT, *supra* note 23, at 82-86.

<sup>174</sup> Much of the literature traces this view to the American realist school and its acknowledged leader, Karl Llewellyn. See Zipporah B. Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465, 493 (1987). In this article the author comments on Llewellyn:

As his 1930 Casebook demonstrates, Llewellyn recognized early on the gap between the Uniform Sales Act's approach to sales and the commercial realities of his day. It was not simply that the Act failed to take account of growing complexities but that its approach had little to do with the facts of the transactions it governed.

*Id.* When Llewellyn took charge of the Code project and assumed responsibility for drafting article 2 he was provided with the perfect opportunity to apply his realist method to commercial law. Not only did Llewellyn believe that an understanding of commercial practices was an essential criterion for effective legislative drafting, he also believed that it was an indispensable component of the judicial process. He, therefore, drafted article 2 with flexible standards and in such a way that also required a court to familiarize itself with relevant commercial practices.

[U]tilizing flexible standards, such as commercial reasonableness and

underlying transactions and the behavior of the transactors, but also of the effects of legal procedure and of the social, economic, and technological environment. Surely, the behavior of buyers and sellers cannot be understood without understanding their external environment. One of the most remarkable features of the article 2 revision process is that drafting decisions are being made without supporting evidence. Instead of verifiable facts, the Article 2 Drafting Committee is forced to rely on shared assumptions and guess at which drafting strategies will accomplish their objectives.<sup>175</sup> The result is a series of revisions that may be effectual, ineffectual or, perhaps, will make matters worse. There is simply no way to know.<sup>176</sup>

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good faith, rather than rules that purport to capture and solidify prevailing practices and norms. Each dispute between a seller and buyer is placed in its functional setting where the parties are expected to find and prove relevant "habits," i.e., trade usage or practices, as part of the agreement. Under these standards, the court is given flexibility (at some cost to certainty and administrability) to resolve the new or unique dispute. Moreover, standards are thought to reduce the gap between law and practice and to insure that decisions are practical and responsive to the needs, proven in the particular case, of the parties and the relevant business community.

PEB STUDY GROUP, PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, UNIFORM COMMERCIAL CODE ARTICLE 2 PRELIMINARY REPORT 9 (1990) [hereinafter PEB ARTICLE 2 REPORT] (clarifying underlying policies behind article 2 drafting). At this juncture it is important to note that Llewellyn never believed, nor do we, that statutory law ought to reflect commercial practices in all cases. For Llewellyn, "merchant reality included a strong normative component, expressed in his efforts both to impose the 'better' mercantile practice on merchants and to avoid imposing unfair obligations on consumers." Wiseman, *supra*, at 469 n.13. Thus, although Llewellyn sought to eliminate the cleft between "is" and "ought," it was not always a matter of the "ought" acquiescing in the "is." Sometimes he felt that it was necessary for the Is to conform to the Ought. However, in the words of Elizabeth Warren: "You can't talk about 'ought' without identifying the presumptions about what 'is.' And to talk about one without the other is to be nonsensical." Elizabeth Warren, *Comments on Professor White's Paper*, 1988 ANN. SURV. AM. L. 49, 55. See generally James J. White, *Promise Fulfilled and Principle Betrayed*, 1988 ANN. SURV. AM. L. 7, 16-42 (discussing legal realism and Karl Llewellyn in context of UCC article 2).

<sup>175</sup> This problem is not unique to the article 2 project. For example, Professor White, the Reporter for revised article 5, laments that "the debate over law is . . . almost completely devoid of reliable empirical data." James J. White, *The Impact of Internationalization of Transnational Commercial Law: The Influence of International Practice on the Revision of Article 5 of the U.C.C.*, 16 NW. J. INT'L L. & BUS. 189, 213 (1995).

<sup>176</sup> This conclusion should come as no surprise to anyone who thinks about the legislative process. On this point Llewellyn observed:

The field of Law reaches both forward and back from the Substantive Law of school and doctrine. The sphere of interest is widening; so, too, is the scope of doubt. *Beyond rules lie effects* — but do they? Are some rules mere paper? And if effects, what effects? Hearsay, unbutressed guess, assumption or assertion unchecked by test — can such be trusted on this matter of what law is *doing*?

It is useful to note the nature of what often has passed for evidence of how the system operates. Much of what dominates discussion about article 2 and its revision consists of conclusory assertions, without reliable data to sustain them. These are proffered to the Drafting Committee not just by the lobbyists whose job it is to push a particular version of commercial reality, but also by the advisors and observers who regularly attend the drafting meetings and even by the committee members themselves. In other words, all participants are equally guilty. The following are several examples of this so-called "evidence."

One advertising agency informs the Drafting Committee that "[n]ot only do [consumers] know puffery when they hear it, they can spot it a mile away. Today's consumers are infinitely more skeptical than any generation of consumers before them."<sup>177</sup> Another agency is convinced that famous slogans such as "You can be sure if its Westinghouse" are never misunderstood. It states: "Was any consumer ever misled into thinking any of this harmless puffery was really a warranty? Of course not."<sup>178</sup>

Other examples come from the pen of trade associations. Consider the statement by the National Retail Federation that "[w]hile [the Statute of Frauds] may sometimes be used by those who wish to avoid their contractual obligations, it is more frequently used to cut off those who seek to invent contractual obligations where none exist."<sup>179</sup> The National Electrical Manufacturers Association purports to sum up the substance of commercial agreements by claiming:

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Karl Llewellyn, *Some Realism About Realism — Responding to Dean Pound*, 44 HARV. L. REV. 1222, 1222-25 (1931) (responding to Dean Pound's assertions about realism determining that other fields are influencing law today). This same concern was voiced by the Article 2 Study Committee. See PEB ARTICLE 2 REPORT, *supra* note 174, at 7 (noting that it is "hard to be accurate without knowledge of relevant practices"). It has also been echoed by commentators galore. See, for example, Warren, *supra* note 174, at 52:

To impose statutory "solutions" means that there has to be much more information about how the system operates generally. What that means ultimately — and the legal realists, I think saw this from the beginning — is that without empirical work of some kind, you can't go forward. You can't make good decisions.

<sup>177</sup> Letter from DMB&B to Hall Dickler Kent Friedman & Wood LLP (Jan. 30, 1995) (on file with author).

<sup>178</sup> Letter from Lenac, Warford, Stone, Inc. to Hall Dickler Kent Friedman & Wood LLP (Feb. 2, 1995) (on file with author).

<sup>179</sup> Letter from the National Retail Federation to the National Conference of Commissioners on Uniform State Laws (Apr. 19, 1994) (on file with author).

We maintain that the true expectations of commercial buyers and sellers are for contract terms substantially more favorable to sellers than those provided by the Code gap fillers. Negotiated contracts between commercial buyers and sellers bear this out, for those contracts typically restrict the buyer's recovery of consequential damages, often shorten the statute of limitations, routinely disclaim implied warranties and replace them with express warranties, and otherwise modify the remedy provisions of Article 2 in favor of the seller's interests.<sup>180</sup>

Two final examples are taken from the unofficial minutes of one of the Drafting Committee's many meetings. During a discussion on coverage of services, the members of the Drafting Committee were told "that frequently the service supplier was a third party" and "that services contracts were often warranty substitutes."<sup>181</sup>

The preceding examples should suffice to make the point. While each of these "facts" is a plausible account of reality in the world at large, none is offered with enough evidence to convince us that they should serve as a valuable guide to law reform.

A second source of information for decisions by the Drafting Committee is anecdotal evidence derived from the many stories told by those who participate at drafting meetings and the content of more than forty years of Code case law. While we readily admit that storytelling has some evidentiary value, we believe that its persuasive power far exceeds its worth. To be fair, we are not talking about the individual who says "I know . . ." or "I'm sure it operates that way because I practiced law for an hour and a half."<sup>182</sup> Such persons are easily ignored. Our concern is with statements made in apparent good faith by experienced commercial practitioners. Even if we were to concede their absolute truth (which we do not)<sup>183</sup> this is not the type of data that one can comfortably rely upon to draw correct inferences about whatever it is that we are trying to understand. Hearing people talk about the cases that they have litigated or otherwise been involved with in their particu-

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<sup>180</sup> Letter from the National Electrical Manufacturers Association to Lawrence J. Bugge, Committee Chair, & Richard E. Speidel, Reporter, (Sept. 13, 1993) (on file with author).

<sup>181</sup> Thomas J. McCarthy, Chair of A.B.A., Remarks at the Meeting of Drafting Committee (Mar. 10-12, 1995) (on file with author).

<sup>182</sup> Warren, *supra* note 174, at 53.

<sup>183</sup> The explanation for distorted portrayals of actual cases, even where there has been no attempt at fabrication, is that we no doubt tend to forget certain details with the passage of time and our memories are, to some degree, selective.



lar practice tells us almost nothing about the overall frequency of such occurrences, their causes and effects, or how people behave in other industries and contexts.

Yet what about the case law? For obvious reasons cases form the principal data base from which the Drafting Committee seeks its information about the real world; cases cost little to access and all Committee members have been trained to read and understand them. On reflection, however, relying on cases is to say, "like the drunk looking under the lamppost, 'Hey, [we] have to look where the information is.' [We] don't have the time, the energy, the money and for many people, one would add, in a lot of contexts the skills, to go out there and look at life itself."<sup>184</sup> Cases simply do not provide the information needed to assess the system.

One difficulty with relying on cases is that they only tell stories of deals gone bad. However, the overwhelming bulk of transactions do not break down, and of those that do, most are presumably settled without litigation. In those situations where a lawsuit does result or the parties invoke some other formal dispute resolution mechanism, only a small percentage of cases will lead to a published opinion. What we find, therefore, scattered throughout the volumes of the various reporter systems is, at best, a very small and aberrational subset of commercial activity.

Another reason for discounting the empirical value of cases is that they are by necessity always backward looking. The cases tell us about yesterday's transactions. What cannot be seen, but can only be guessed at, is the impact of the Code on what people do. For example, Professor James White posits that the original Code drafters botched section 2-207 because "they grossly overestimated their knowledge of the underlying transactions."<sup>185</sup> To make his point, White counts twenty-seven "hard" cases in six of the then most recent volumes of the UCC Reporting Service.<sup>186</sup> Taken together, all of these cases might suggest that at the outset the drafters misconceived contracting practices. However, it may be that this original disjunction of law and practice has been sufficiently eroded by the passage of time so that section 2-207 is no longer a statutory problem in need of a fix. This may explain why

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<sup>184</sup> See Richard Danzig, *Comments on Professor White's Paper*, 1988 ANN. SURV. AM. L. 56, 57 (1998) (discussing Professor White's focus on realism and concluding that realists fail to analyze how law impacts life).

<sup>185</sup> White, *supra* note 174, at 33.

<sup>186</sup> See 40-42 U.C.C. Rep. Serv. (CBC); 1-3 U.C.C. Rep. Serv. 2d (CBC).

there are only two cases in a later, randomly selected, volume of the same reporting service.<sup>187</sup> Moreover, we have heard it said, time and time again at drafting meetings, that the commercial community has learned to play the “battle of the forms” game. This illustrates that it is not enough to look only at the number of cases.<sup>188</sup> Unless we pay attention to the timing of the cases and look at the way practices have evolved over time, we are unlikely to get the data that we need to make the right legislative choices.

The Drafting Committee’s recent decision to retain and revise the Statute of Frauds is perhaps the clearest example of a determination made without an empirically validated model of behavior to support it.<sup>189</sup> And that is too bad, because much of the rhetoric surrounding the Statute has always hinged on untested factual assertions. Specifically,

[c]ommentators have criticized the statute on the grounds that it does not reflect actual practices in the business community and serves as an instrument rather than a preventative of fraud, since it is invoked only to enable a party to renege on an oral business deal which he was reasonably expected to honor. It is further ar-

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<sup>187</sup> See 14 U.C.C. Rep. Serv. (CBC).

<sup>188</sup> Indeed, even the total absence of cases on a particular issue does not necessarily mean that the status quo should be maintained. The rule in question still must be evaluated in terms of its overall effect. See, e.g., Danzig, *supra* note 184, at 59.

The law is . . . simply an anvil. On that anvil the individual parties are going to hammer out results. The anvil is fascinating. We can spend hours analyzing how it should be constructed and how varying the angle in one degree or another — varying the surface or the character of materials — should be good or bad. But in the end, the process of hammering out is crucial, and about that process we know terribly little. . . . I think it is a crucial area. One then asks about the anvil, how does it affect the disposition of real cases in an everyday way? How does it affect the settlement process, etc.?

*Id.*

<sup>189</sup> The decision to delete the Statute of Frauds was one of the Committee’s first drafting decisions. See U.C.C. § 2-201 (Discussion Draft, Dec. 21, 1993).

This result was strongly recommended by the PEB Study Group and was approved by the Drafting Committee on March 6, 1993. A motion to restore the statute of frauds was rejected by a voice vote of the Commissioners at the 1995 and 1996 Annuals [sic] Meeting of NCCUSL.

However, at the November, 1996 meeting, the Drafting Committee decided to restore “some version” of the statute of frauds.

*Id.*

gued that the Statute's conclusive presumption of invalidity serves no useful purpose, since modern fact-finding techniques will allow the triers of fact to ascertain accurately the existence or absence of an agreement. On the other hand the Statute is not without defenders. They assert that it represents contemporary business practice, which is partly a normative effect of the Statute; that the observance of written formalities is a healthy procedure tending to eliminate uncertainty in business transactions; and that the Statute encourages such procedure by rewarding businessmen who insist upon adherence to the formalities.<sup>190</sup>

Yet, the only empirical study regarding relevant business practices of which we are aware was published more than forty years ago in the *Yale Law Journal*.<sup>191</sup> It makes a difference if for every anecdote in which a fabricated contract is claimed, one, ten, one hundred, or one thousand deserving plaintiffs are barred from relief because of their inability to satisfy the Statute's mandate. Notwithstanding the absence of reliable up-to-date information, the Drafting Committee not only reversed its previous decision and decided to include a Statute of Frauds within the new article 2, but it went ahead and substantially rewrote its text.<sup>192</sup> To move from a decision to retain the Statute to a decision to alter radically its substance is quite a leap. But leap the Committee did, oblivious to the resulting implications.<sup>193</sup>

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<sup>190</sup> Comment, *The Statute of Frauds and the Business Community: A Re-Appraisal in Light of Prevailing Practices*, 66 *YALE L.J.* 1038, 1038-39 (1957) (discussing Statute of Frauds' place in contemporary business practices).

<sup>191</sup> See *id.* The study disclosed that "the promises of businessmen usually satisfy the requirements of the Statute of Frauds." *Id.* at 1042 (studying manufacturer's compliance with Statute of Frauds in dealings with customers suppliers). However, "oral promises are more prevalent in the transactions of small manufacturers than in the dealings of large ones." *Id.* at 1051.

<sup>192</sup> See U.C.C. § 2-201(c)(2) (Tentative Draft, Mar. 1, 1998). As the notes to the draft section explain, "[s]ubsection (c)(2) expands the 'part performance' exception in section 2-201(3)(C). Conduct by both parties, including part performance, takes the case out of the statute and proof of agreed quantity is not limited to the quantity represented by part performance." *Id.*

<sup>193</sup> The decision by the drafters to weaken considerably the Statute is particularly surprising because the reversal in position was prompted, in large measure, by the business community's negative response to the drafters' original decision to drop the Statute. See Letter from Caterpillar Inc. to Edith O. Davies, Executive Secretary, NCCUSL page (Dec. 14, 1994) (on file with author). Now, no one is very happy. The drafters cannot be particularly pleased because they wanted the Statute gone and, in its present form, business is still dissatisfied. See, e.g., Letter from the American Automotive Leasing Association to Reporters Richard E. Speidel & Linda Rusch (May 14, 1997) (on file with author).

Without taking issue with the specific provisions of revised section 2-201 or, for that matter, any of the other proposed changes to article 2, we believe that the general approach of the drafting process is wrong: wrong because it is not grounded in circumstances of which the drafters are aware. We recognize as much as anyone that empirical data can be expensive, time consuming, and difficult to produce. But to proceed without a clear understanding of the system and its environment is foolhardy. In our view it is better to leave well enough alone than it is to draft a statute that may be deficient in many important respects.

### CONCLUSION

In *The Common Law Tradition: Deciding Appeals*, Karl Llewellyn compared judicial methods of decision making to those of surgery. First, he noted, comes "the effort to diagnose the significant problem involved, and . . . the effort to mark out the life-situation which gives rise to the problem."<sup>194</sup> Only if the problem is rightly diagnosed, can the judge "determine . . . the most appropriate line of treatment and [make] the specific prescription which may be called for."<sup>195</sup> We suggest that both "diagnosis" and "prescription" are also key components of the legislative method.

In our view, the Article 2 Revision Committee fails here. Apart from the difficulties in understanding what constitutes successful legislative performance, it seems clear that the current article 2 revision is flawed as a consequence of fundamental deficiencies in the process. The primary reason for our pessimistic assessment of the efficacy of this particular legislative revision effort is that the Committee's sensitivity to overall context (both legal and behavioral) is attenuated at best and is largely limited to generalized statements of law and commercial behavior offered by those who regularly attend the meetings of the Drafting Committee. Indeed, our experience indicates that credible evidence of trade practices is frequently a less salient determinant of diagnosis and prescription than such nonsubstantive factors as the desire to achieve a superficially appealing revision package. Consider, for example, the question of whether consumers warrant greater protection in

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<sup>194</sup> KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 450 (1960) (stating that clarity is important in establishing new rule of law).

<sup>195</sup> *Id.* Llewellyn believed that "rightly diagnosed types of problem-situation[s] [are] the key to good law and good judging." *Id.* at 324.

the UCC than has traditionally been the case. Although the argument for a more consumer friendly statute is fairly straightforward, determination of the extent to which article 2, or any other Code article, should be consumer friendly is less certain. Without more elaborate or precise information supporting consumer concerns, persuasive argument regarding the appropriate degree of legislative protection is impossible.

In sum, if the Committee's efforts are to achieve long term success, it must be afforded more guidance than it currently receives. We do not mean to suggest that open discussion at Committee meetings be avoided and replaced by research alone. We do, however, emphasize the necessity for systematically evaluating proposals before changes are made. In order to maximize options for change and vigorously assess revisions, more information about the commercial law system is needed. Only if the Drafting Committee pays careful attention to "the health of the whole"<sup>196</sup> will overall equilibrium be maintained.

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<sup>196</sup> See E. ADAMSON HOEBEL & KARL N. LLEWELLYN, *THE CHEYENNE WAY* 332 (1941) (reconciling law justice problems in various cultures).