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U.C.C. Survey: General Provisions, Bulk Transfers, and Documents of Title

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General Provisions, Sales, Bulk Transfers, and Documents of Title

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This survey reviews recent case law and related developments under articles 1, 2, 6, and 7 of the Uniform Commercial Code ("U.C.C." or "Code").

GENERAL PROVISIONS

There were no cases of significant interest under article 1 during the period of this survey.

ARTICLE II—SALES OF GOODS

CONTRACT FORMATION AND TERMS

Statute of Frauds

Perhaps the most important lesson to be learned from this year's statute of frauds cases is that the traditional sales model embraced by U.C.C. section 2-201 will make it increasingly difficult for courts to apply the statute to non-traditional documentation. Consider, for example, *Procyon Corp. v. Components Direct, Inc.*[1] There the "writing in confirmation of the contract" that was found to satisfy section 2-201(2)[2] was an irrevocable letter of credit issued by the

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Authors' note: All citations to the Uniform Commercial Code are to the 1987 Official Text, unless otherwise noted.

1. 249 Cal. Rptr. 813, 6 U.C.C. Rep. Serv. 2d (Callaghan) 655 (Cal. Ct. App. 1988).
2. U.C.C. § 2-201(2) provides:

> Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.

buyer's bank to the seller's bank. The letter of credit included a description of the contract's subject matter, sales price, date of delivery, identification of the parties, and the bank's warranty that all requests for payment in accordance with the terms of sale would be promptly fulfilled. But where was the buyer's signature? After all, a confirmatory memorandum under subsection (2) must be "sufficient against the sender" under subsection (1) and that subsection clearly requires a signature.[3] Not so, said the court. To import that requirement into subsection (2) "defeats the goal of quick, informal confirmations of business deals, and lacks support in the Commercial Code."[4] Despite this erroneous reading of the section,[5] the court went on to decide that the credit had indeed been "signed" by the buyer.[6] The bank acted as the buyer's agent when it sent the credit so its signature was thus adopted by the buyer.

Although the court's analysis is open to question, the result accords with reason. Certainly the establishment of a credit provides us with good reason to believe that a contract exists. Nevertheless, to preclude proof of that contract seems more likely to aid in the perpetration of a fraud than in its prevention. In this regard the situation is not much different from those singled out for exceptional treatment in section 2-201(3).[7] The real problem with section 2-201 might be not its presence within the Code, as some have suggested,[8] but, rather, its specificity. Maybe its purpose would be better served by a more general provision requiring no more than that a contract be proved, at least in part, by facts, other than the oral testimony of the parties, that reasonably tend to support its existence.[9]

Take another case decided this year, *McClure v. Duggan*.[10] During negotiations for the sale of a European race horse, the parties approached an insurance agency for the purpose of determining whether the horse could be insured. In connection with this inquiry the agency prepared two documents: (i) an application for insurance and (ii) an order for livestock insurance. When the buyer sued for nondelivery, the seller moved for summary judgment. The district court

3. Under U.C.C. § 2-201(1), the writing must be "signed by the party against whom enforcement is sought or by his authorized agent or broker."

4. 249 Cal. Rptr. at 815, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 657.

5. Not all courts have so misread subsection (2). *See, e.g.*, Mel-Tex Valve, Inc. v. Rio Supply Co., 710 S.W.2d 184, 2 U.C.C. Rep. Serv. 2d (Callaghan) 55 (Tex. Ct. App. 1986) (unsigned confirmatory memorandum cannot satisfy the exception).

6. *See* U.C.C. § 1-201(39) (" 'Signed' includes any symbol executed or adopted by a party with present intention to authenticate a writing.").

7. *See* U.C.C. § 2-201(3)(a)–(c). Each exception "is a kind of special indicator that a contract, albeit oral, was in fact made." J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 2-5, at 83 (3d ed. 1988).

8. *See generally* Bruckel, *The Weed and the Web: Section 2-201's Corruption of the U.C.C.'s Substantive Provisions—The Quantity Problem*, 1983 U. Ill. L. Rev. 811.

9. This concept "could be described as a 'finger pointing' rule where the objective conduct, as distinct from oral testimony as to conversations, demonstrates the existence of a contract with a particular subject matter." Leary & Frisch, *Is Revision Due for Article 2?*, 31 Vill. L. Rev. 399, 462 (1986).

10. 674 F. Supp. 211, 5 U.C.C. Rep. Serv. 2d (Callaghan) 925 (N.D. Tex. 1987).

correctly held that neither individually nor collectively were the forms sufficient to satisfy the written memorandum and signature requirements of section 2-201.[11] As the court saw it, even if the forms had been signed by the seller they were, at best, nothing more than evidence of "mere" negotiations for the sale of the horse.[12]

The requisites of section 2-201 aside, it is clear that an insurance application is markedly different in terms of evidentiary persuasiveness from the establishment of a letter of credit. Insurance protection is often acquired in anticipation of a contract, whereas the acquisition of a credit is always an act in performance of a contract. One would expect that a statute of frauds, however written, would capture this difference.

In those instances where a party cannot overcome the evidentiary barrier of section 2-201, there is still a glimmer of hope where it has been held that the equitable principle of promissory estoppel is an exception to the statute.[13] In *Allied Grape Growers v. Bronco Wine Co.*,[14] a California appellate court held for the first time that U.C.C. sections 1-103[15] and 1-203[16] support such an exception. The court repeatedly cautioned that its decision was not to be read as

11. The Livestock Insurance form did contain the seller's name, but it was placed there by the insurance agent. The court thought it "preposterous to contend that an independent insurance agent, acting on behalf of both parties to obtain insurance, could bind one of those parties to a contract for the sale of a $600,000 thoroughbred race horse." *Id.* at 217, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 931. If the court meant what it said, it failed to grasp the significance of what it means to satisfy the statute. Neither party is bound to a contract unless there is sufficient proof that one in fact exists. Being able to satisfy the statute does no more than open the door to such proof. The court further stated that the agent's authority was limited to seeking and obtaining insurance. But—for the purpose of the signature requirement of § 2-201—in what manner is this authority more restricted than that of a bank which issues a letter of credit?

12. The court relied heavily on Oakley v. Little, 49 N.C. App. 650, 272 S.E.2d 370, 30 U.C.C. Rep. Serv. (Callaghan) 675 (N.C. Ct. App. 1980) (holding that the purchase of term life insurance showed only that the parties were progressing toward an agreement, not that a final agreement had been reached).

13. *Compare* Allen M. Campbell Co. v. Virginia Metal Indus., 708 F.2d 930, 36 U.C.C. Rep. Serv. (Callaghan) 384 (4th Cir. 1983) (promissory estoppel permitted as exception to statute of frauds) *and* R.S. Bennett & Co. v. Economy Mechanical Indus., 606 F.2d 182, 27 U.C.C. Rep. Serv. (Callaghan) 345 (7th Cir. 1979) (same) *and* Warden & Lee Elevator, Inc. v. Britten, 274 N.W.2d 339, 25 U.C.C. Rep. Serv. (Callaghan) 963 (Iowa 1979) (same) *with* C.R. Fedrick, Inc. v. Borg-Warner Corp., 552 F.2d 852, 21 U.C.C. Rep. Serv. (Callaghan) 26 (9th Cir. 1977) (promissory estoppel not permitted as exception to statute of frauds) *and* McDabco, Inc. v. Chet Adams Co., 548 F. Supp., 34 U.C.C. Rep. Serv. (Callaghan) 1101, 456 (D.S.C. 1982) (same) *and* Lige Dickson Co. v. Union Oil Co., 96 Wash. 2d 291, 635 P.2d 103, 32 U.C.C. Rep. Serv. (Callaghan) 705 (1981) (same).

14. 249 Cal. Rptr. 872, 6 U.C.C. Rep. Serv. 2d (Callaghan) 1059 (Cal. Ct. App. 1988).

15. U.C.C. § 1-103 provides:

> 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.

16. U.C.C. § 1-203 states: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."

a nullification of section 2-201. Not only must there be a change of position in reliance on the oral contract, but also the aggrieved party must suffer "unconscionable injury"[17] if enforcement of the contract is denied.

Finally, in *Dairyland Financial Corp. v. Federal Intermediate Credit Bank of St. Paul,*[18] the Seventh Circuit was faced with the application of the statute of frauds provision of U.C.C. section 1-206 to the purported sale of a loan portfolio. The court ruled that although not specifically codified as an exception, the part performance doctrine survives and supplements the section. Unfortunately for the plaintiff, the doctrine was inapplicable on the facts presented.

Parol Evidence

In *Tigg Corp. v. Dow Corning Corp.,*[19] the Third Circuit, applying Michigan law, considered the extent to which section 2-202 permits the admission of extrinsic evidence to interpret a written contract. In that case the seller (Tigg) and the buyer (Dow) entered into a joint effort to develop a system for filtering PCBs from transformer cooling liquids. They signed two contracts prepared by the buyer which required the buyer to purchase from the seller specified minimum yearly quantities of two components for the filtration system. The contracts also provided that the parties would meet annually, if necessary, to adjust the specified minimum quantities. The buyer failed to purchase the specified annual minimum quantities for two years, and so the seller sued. In its defense, the buyer contended that the contracts were only requirements contracts and that it had no obligation to purchase the stated minimum quantities. In support of this, the buyer proffered extrinsic evidence including letters exchanged by the parties during negotiations which could be interpreted as supporting the buyer's contention. The district court refused to consider this extrinsic evidence. It considered the contracts to be facially unambiguous about the minimum quantities and so treated the buyer's extrinsic evidence as inadmissible under section 2-202. Consequently, the district court granted partial summary judgment for the seller.

On appeal, the Third Circuit reversed and remanded the case for trial. The court reasoned that the contracts had first to be interpreted. Only then could it be known what extrinsic evidence contradicted the contracts and therefore was to be excluded by section 2-202. It then established a two-step process of interpretation. First, the court decides if the contract was ambiguous, that is, whether it was susceptible of more than one meaning. In making this decision, the court considers all proffered extrinsic evidence. Second, if it concludes that the contract is ambiguous, then the court submits to the fact finder the question of which meaning the parties intended. On this point the fact finder considers all

17. "Unconscionable injury results from denying enforcement of a contract after one party is induced by another party to seriously change position relying upon the oral agreement. It also occurs in cases of unjust enrichment." 249 Cal. Rptr. at 878, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 1071.

18. 852 F.2d 242, 6 U.C.C. Rep. Serv. 2d (Callaghan) 622 (7th Cir. 1988).

19. 822 F.2d 358, 4 U.C.C. Rep. Serv. 2d (Callaghan) 44 (3d Cir. 1987).

relevant extrinsic evidence.[20] Applying this test, the Third Circuit concluded that the contract could support the buyer's interpretation and so the proffered extrinsic evidence should have been considered by the fact finder. Consequently, it reversed the grant of summary judgment.

Battle of the Forms

This year there was a spate of cases in which one party signed the other's form. In one case the signing party avoided summary judgment by raising a factual question about the signing agent's authority to agree to terms different from those on the signing party's own form.[21]

In *Southeastern Adhesives Co. v. Funder of America, Inc.,*[22] the North Carolina Court of Appeals did not impose boilerplate terms in the signed form upon the signing party. In that case the buyer had purchased urea resin from the seller for some ten years. In each of the four transactions in suit the parties followed the same procedure: The buyer ordered resin by telephone. Shortly after, the seller shipped the resin accompanied by a bill of lading. The buyer signed the bill of lading to acknowledge receipt of the resin. The back of the bill of lading bore disclaimers of the merchantability and fitness for particular purpose warranties. Later the buyer would send a written purchase order and the seller would invoice the buyer.

In each transaction the buyer refused to pay, claiming the resin was defective. The seller sued for the purchase price and the buyer counterclaimed for breach of warranties. On the seller's motion for summary judgment, the trial court gave judgment for the seller on both the warranty counterclaim and main claim for the price. On appeal, the court determined that the seller had not disclaimed the implied warranty of merchantability and that whether this warranty had been breached was a question of fact. The appeals court reversed that portion of the judgment and remanded for trial.

The seller argued on appeal that the buyer had agreed to a disclaimer of the merchantability warranty when it signed the bill of lading bearing that disclaimer. The court, however, disagreed. It found that the contract had been formed earlier, when the buyer telephoned in its order. It then viewed the disclaimer as a proposal for an additional term under section 2-207(2) which did not become part of the contract because it materially altered it. Presumably the court was unwilling to enforce the disclaimer because it had not been explicitly negotiated by the seller. The court may also have been influenced by

20. The court would exclude from the fact finder's consideration extrinsic evidence that is inconsistent with the express language of the contract, *Id.* at 363, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 52 (on the theory that evidence interpreting the contract is admissible under § 2-202 if it explains or supplements the contract language but not if it contradicts that language).

21. *See* Ocor Prods. Corp. v. Walt Disney Prods., 682 F. Supp. 90, 6 U.C.C. Rep. Serv. 2d (Callaghan) 675 (D.N.H. 1988).

22. 89 N.C. App. 438, 366 S.E.2d 505, 6 U.C.C. Rep. Serv. 2d (Callaghan) 403 (N.C. Ct. App. 1988).

the fact that the document signed, a bill of lading, ordinarily is signed merely to acknowledge receipt of goods, not to assent to terms of the contract of sale.

In a case involving similar facts, *International Tin Council v. Amalgamet Inc.*,[23] a New York trial court bound the signing party to a boilerplate arbitration clause contained on the reverse side of the signed form. There the parties had done business with each other for some three years and thirty-eight transactions. Each transaction followed a similar procedure: The parties would agree by telephone to terms for the sale of tin to the buyer (International Tin Council) by the seller (Amalgamet); the seller would then confirm the agreement by telex and also send its signed confirmation for the buyer to sign and return. The reverse side of the confirmation contained an arbitration clause. Habitually the buyer would sign the front of the confirmation and return the confirmation. When the market price of tin collapsed, the buyer refused to honor three sales. Subsequently, the buyer petitioned the court to stay arbitration. The court decided that the buyer was bound to the arbitration clause because it had signed the confirmation.[24]

In *Tri-State Petroleum Corp. v. Saber Energy, Inc.*,[25] the Fifth Circuit, applying Texas law, held that one who adds a term to a proposed contract and then signs the contract assents to the contract without the added term. In that case the buyer (Tri-State Petroleum) needed to obtain a gasoline source for a specific cancellable resale contract. According to industry custom, it arranged with a broker to locate a source. The broker negotiated the terms of a six-month gas supply agreement with a refinery (Saber Energy). The refinery prepared a draft of a formal contract which it signed and sent to the broker who forwarded it to the buyer. The draft provided: "Except as otherwise provided on the face hereof, buyer may not cancel this agreement under any circumstances without [the refinery's] written consent." The buyer typed a cancellation clause on the draft's first page, signed it, and returned the draft to the broker along with a cover letter explaining that the cancellation clause had been added. The broker forwarded the draft but not the cover letter to the refinery who retained it without objection. After the first gasoline delivery, the buyer's purchaser cancelled the resale contract with the buyer, and the buyer sought to do the same with the refinery contract. The refinery objected and set off its claim for breach against money which the refinery owed the buyer on an unrelated contract. When the buyer sued on the unrelated contract, the refinery filed a counterclaim

23. 138 Misc. 2d 383, 524 N.Y.S.2d 971, 5 U.C.C. Rep. Serv. 2d (Callaghan) 330 (N.Y. Sup. Ct. 1988).

24. The buyer did not sign the confirmation for the last transaction apparently because the market price had already fallen. The court held that, given the buyer's past course of conduct in signing the confirmations, its retention of the last confirmation without objection constituted a tacit acceptance of the arbitration clause contained in it. Generally, retention of a form without objection does not constitute acceptance of that form's terms. 3 R. Deusenberg & L. King, Bender's Uniform Commercial Code Service—Sales & Bulk Transfers § 3.06[1] (1988). Where however, a past course of conduct indicates that a term is acceptable, silence can constitute assent to that term. *Cf.* Restatement (Second) of Contracts § 69(1)(c) (1981).

25. 845 F.2d 575, 6 U.C.C. Rep. Serv. 2d (Callaghan) 368 (5th Cir. 1988).

for damages for breach of the gasoline contract. A magistrate tried the counterclaim and held that the cancellation clause did not become part of the contract. The magistrate reasoned that the refinery had made an offer by sending the draft and that the buyer had accepted that offer by signing the contract. The magistrate treated the cancellation clause as an "additional or different term" under section 2-207 which did not become part of the contract. Thus when the buyer purported to cancel the contract it was in breach. The Fifth Circuit affirmed this result.

One may question whether this case properly has anything to do with section 2-207. That section is intended to cover two situations: (i) the written confirmation of a prior agreement and (ii) offer and acceptance involving either an acceptance containing minor additional terms or an exchange of forms containing differing boilerplate.[26] The contract in question apparently was not a form but a draft contract. Additionally, the so-called "acceptance" contained a major different term, the cancellation clause, and conventional section 2-207 wisdom suggests that a response such as the one in this case which varies an important dickered term cannot be an acceptance under section 2-207(1).[27] Perhaps a better basis for the decision would have been that, to a reasonable person, the buyer's response manifested assent to the unamended draft. Even though the buyer added the cancellation clause before it signed, its agent, the broker, failed to call the refinery's attention to that addition. Therefore the refinery was reasonable in assuming that the buyer had accepted its offer of a non-cancellable contract.

The *Roto Lith* doctrine[28] is still alive and well in the First Circuit. In *Alloy Computer Products v. Northern Telecom, Inc.*,[29] the United States District Court for Massachusetts, applying Massachusetts law, declared that the *Roto Lith* case, though criticized by both academics and judges, was still good law, at least within Massachusetts. In *Alloy Computer Products,* the parties entered into a series of contracts for computer tape drives. In each negotiation they followed the same procedure: The buyer sent a purchase order for tape drives; the seller responded by shipping the goods and sending a letter containing its "General Terms and Conditions of Sale." The terms and conditions included a clause giving an express warranty, the remedy for which expressly was limited to repair or replacement of defective goods; the clause also disclaimed all other warranties. The buyer accepted and used the tape drives. Subsequently, the buyer sued the seller for, inter alia, breach of warranty, claiming that the seller had represented to the buyer that it would deliver drives with long-lasting ceramic coated magnetic heads but that the seller had delivered shorter-lived non-ceramic heads. Both parties moved for summary judgment on the buyer's

26. U.C.C. § 2-207 Official Comment 1.

27. *See* J. White & R. Summers, Uniform Commercial Code 47 n.71 (3d ed. 1988), and cases cited therein.

28. *See* Roto Lith, Ltd. v. F.P. Bartlett & Co., 297 F.2d 497, 1 U.C.C. Rep. Serv. (Callaghan) 73 (1st Cir. 1962).

29. 683 F. Supp. 12, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1302 (D. Mass. 1988).

warranty claims. The court held that the seller's warranty limitation clause was part of the contracts between the parties and granted summary judgment for the seller. Following *Roto Lith*, the court held (i) that the seller's letter enclosing its "General Terms and Conditions of Sale" was a counteroffer because it materially altered the buyer's purchase order terms, and (ii) that the buyer accepted the seller's warranty limitation clause in the counteroffer when it accepted the tape drives.[30]

Output and Requirements Contracts

Suppose a buyer who previously had no requirements for certain goods contemplates making a change in its business that will cause it to need those goods. It then signs a requirements contract for the goods. Can the buyer then decide not to make the business change and not be liable on the requirements contract?

In *Empire Gas Corp. v. American Bakeries Co.*,[31] the Seventh Circuit, applying Illinois law, said that the buyer could not avoid liability. In that case a propane retailer (Empire Gas) contracted with a bakery (American Bakeries) to sell to the bakery conversion units so that the bakery could convert its fleet of gasoline delivery trucks to propane burning vehicles. The retailer also agreed to supply the bakery with propane fuel at competitive market prices for four years. The contract was a requirements contract calling for the retailer to furnish "approximately three thousand (3,000) [conversion] units, more or less depending upon requirements of Buyer."[32] Within days of signing the contract, the bakery decided not to convert its vehicles to propane and thus purchased none of the conversion units nor any propane fuel. The bakery gave no reason for this decision.[33] The retailer sued for breach of contract to recover its lost profits. A jury found the bakery to be in breach and awarded $3.25 million to the retailer. The Seventh Circuit affirmed the finding of liability.[34] The bakery had argued that the judge had improperly instructed the jury on the question of whether the

30. The buyer had stated in an affidavit that it had "Specifically objected to [the seller's 'General Terms and Conditions of Sale'] on several occasions in conversations with [the seller's] sales and marketing representatives." The court held this statement to be too vague to raise a material question of fact, because the affidavit did not state what terms were objected to or whether the objections occurred during any of the sales in suit. 683 F. Supp. at 13 n.2, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1303 n.2.

31. 840 F.2d 1333, 5 U.C.C. Rep. Serv. 2d (Callaghan) 545 (7th Cir. 1988).

32. The court of appeals noted that the contract language, "more or less depending upon requirements of Buyer," had been appended to the 3,000-unit figure just in case that estimate was off. The intent was that the bakery could take slightly more or slightly fewer units depending upon its actual needs, and not that the bakery could choose to take none at all. 840 F.2d at 1336, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 549.

33. The court of appeals speculated that the bakery's reason for not taking any conversion units may have been a decision by the bakery's new managers to spend the money budgeted for propane conversion on other projects. 840 F.2d at 1339–41, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 553–56.

34. The court also affirmed the damage award, except for the award of prejudgment interest, which it reversed. 840 F.2d at 1342, 5 U.C.C Rep. Serv. 2d (Callaghan) at 556–57.

bakery could choose to have no requirements under the contract.[35] Over the bakery's objection, the trial judge had read subsection 2-306(1)[36] to the jury without explanation. The court held this to be error, but harmless error. In effect, the court reasoned that, once the retailer had introduced significant evidence of bad faith by the bakery, the burden of production shifted to the bakery to introduce contrary evidence. By refusing to give any reason for its decision not to convert, the bakery failed to carry that burden and thus should have had a directed verdict entered against it. Since it should not have gotten to the jury in the first place, the error in the jury instructions was harmless.

The error in the jury instructions, according to the Seventh Circuit, was to read the "unreasonably disproportionate" proviso of subsection 2-306(1) to the jury.[37] The court held that, where a buyer declares his requirements to be much less than a stated estimate, that proviso does not apply.[38] In that situation the "good faith" test of the first part of subsection 2-306(1) is the only test to be applied.[39] The court based its conclusion on case law and law review articles as well as the wording of the proviso and the Official Comments to the section. The court then proceeded to discuss the "good faith" test as it applied to a decrease in requirements. Clearly, said the court, it would be bad faith for the bakery to reduce its requirements so that it could take advantage of cheaper substitutes, or so that it could injure the retailer because they were competitors in another market. Conversely, continued the court, it would not be bad faith for the bakery to reduce its requirements for business reasons unrelated to the contract or its relationship with the retailer, such as a decline in the demand for bakery products that led it to reduce or abandon its fleet of trucks. Yet here the bakery offered no reason for its decision not to convert. For all that appeared, the bakery had simply changed its mind about converting. The court held that this was not sufficient to satisfy the good faith test. To hold otherwise, said the court, would be to treat the requirements contract as an option contract and this treatment would be inconsistent with both Illinois case law and the Code's coverage of option contracts in a section separate from the requirements contract

35. The bakery also asserted that it was entitled to a directed verdict because the retailer could not furnish conforming conversion units. This argument was based upon the premise that a certain Dutch-made conversion unit (Bé & Bé) had been the basis of the parties' negotiations and therefore were the goods to be furnished under the contract. It further argued that this unit had not worked successfully so that it was not possible for the retailer to supply the agreed upon conversion unit. The court found that the contract was not for the Bé & Bé conversion unit but for any conversion unit that would do the job. Consequently, the court rejected this ground for appeal.

36. U.C.C. § 2-306(1) provides:

> A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

37. *See supra* note 36.

38. 840 F.2d at 1339, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 553.

39. *Id.* The proviso thus applies only where a party seeks to *increase* his requirements or output.

section.[40] Thus a buyer cannot decide to change its business so as to create a need for certain goods, then enter into a requirements contract for those goods and subsequently decide not to change its business and so avoid liability on the requirements contract.

WARRANTIES

General

In *Kirby Forest Industries v. Dobbs*,[41] the Texas Court of Appeals, in dictum,[42] discussed the implied warranty of title under section 2-312. In that case four relatives owned in common four fifty-acre tracts of timberland. They partitioned the land, each taking title to one fifty-acre tract. Later, Pfleider persuaded three of the relatives to sell him their timber rights. Each relative executed a timber deed to Pfleider, who assigned the deeds to Kirby Forest Industries ("KFI"). One of the assigned deeds covered the tract owned by Dobbs. KFI performed a title check and hired a logger to cut the timber. During the logging, the fourth relative (Cook), who had not sold his timber rights, complained to the logger that he was logging the wrong tract. The logger continued to cut. In fact, KFI logged the Cook tract rather than the Dobbs tract. The mistake was induced by an ambiguous reference in the Dobbs timber deed which made it appear as if the property covered by that deed was the tract owned by Cook.[43] Cook sued KFI for converting his timber, and KFI filed a third party complaint against Dobbs and others. The trial court gave judgment for Cook on the conversion claim and for Dobbs on KFI's third party complaint. On KFI's appeal from the judgment on its third party complaint, the court affirmed in part and reversed in part. On the implied warranty of title claim, it reversed the trial court and found the warranty to have been made and breached. The warranty claim was based upon the initial transaction between Dobbs and KFI's assignor Pfleider. The court held that KFI received by assignment Pfleider's implied warranty of title rights against Dobbs.[44] The court also held that this warranty was breached by the ambiguous reference in

40. *See* U.C.C. § 2-311.

41. 743 S.W.2d 348, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1321 (Tex. Ct. App. 1987).

42. The discussion was dictum because the court found that an indemnity clause contained in the relevant timber deed permitted recovery of the losses in suit.

43. When the relatives had partitioned the common ownership, they each took a tract by partition deed. Instead of delineating each tract by metes and bounds description, the partition deeds referred back to the deeds which had conveyed the tracts to the relatives' predecessors in title. Thus the Dobbs partition deed referred to a volume and page for a description of the property it covered. However, that volume and page contained both the end of the deed to what later became the Cook tract, including a metes and bounds description of that property, and the beginning of the deed to what later became the Dobbs tract. The metes and bounds description to what later became the Dobbs tract was contained on the following page. This ambiguous reference in the Dobbs partition deed was copied into the Dobbs timber deed. Thus, the tract described in the Dobbs timber deed appeared to be the tract which Cook owned.

44. The article 2 implied warranty of title applied because the subject matter of the transactions, timber to be cut, was "goods" under article 2. U.C.C. § 2-107(2).

the timber deed from Dobbs to Pfleider. Neither the title search performed by KFI, which had failed to detect the problem, nor the warning to the logger that he was on the wrong land prevented the breach of warranty from being the proximate cause of KFI's conversion liability. Therefore the court ruled that KFI could recover from Dobbs on the implied warranty of title.

In *Hicks v. Thomas*,[45] the Mississippi Supreme Court ruled that the remote purchaser of a truck could sue an earlier seller of the truck for breach of the implied warranty of title. In that case the owner of a truck (Thomas) loaned it to his son-in-law (Cross). The son-in-law fell behind in his house rental payments and abandoned the house together with the truck which was by then in an extreme state of disrepair. The landlord (Daniels) claimed a landlord's lien on the truck and traded it to Ellis who in turn sold it to Hicks. Hicks repaired the truck and sold it to Cooper. The original owner Thomas then sued Cooper to replevy the truck. Hicks refunded Cooper's money, took back the truck, and became the defendant. Hicks also cross-claimed against the landlord and Ellis for breach of warranty of title. The trial court entered summary judgment for the owner of the truck and dismissed Hick's warranty of title claim against the landlord. The Mississippi Supreme Court affirmed the entry of summary judgment for the owner but reversed the dismissal of the warranty of title claim. The court held that, pursuant to a Mississippi statute abolishing privity as a requirement for certain actions including U.C.C. warranty actions, privity was not a requirement in an action for breach of the implied warranty of title.[46]

This year's express warranty cases, as usual, often contain discussions of when an affirmation of fact, promise, description, or sample relating to goods becomes part of the "basis of the bargain" under U.C.C. section 2-313. As the Official Comments indicate, generally affirmations of fact made by the seller about the goods become part of the basis of the bargain, and the burden is upon the seller to provide clear affirmative proof of facts which refute this.[47] The practical effect of this appears to be that the buyer need not allege and prove reliance specifically upon the affirmations. Instead, reliance is presumed and it is up to the seller to rebut that presumption by proving that the buyer could not reasonably have relied.[48]

45. 516 So. 2d 1344, 6 U.C.C. Rep. Serv. 2d (Callaghan) 105 (Miss. 1987).

46. Cases in other states are split on the question of whether a remote purchaser can sue for breach of the implied warranty of title. For cases permitting recovery, see Mitchell v. Webb, 591 S.W.2d 547, 28 U.C.C. Rep. Serv. (Callaghan) 58 (Tex. Ct. App. 1979); *Kirby Forest Indus.*, 743 S.W.2d at 348, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1321 (discussed in text accompanying notes 41–44, *supra*. *But see* Universal C.I.T. Credit Corp. v. State Farm Mut. Auto. Ins. Co., 493 S.W.2d 385, 12 U.C.C. Rep. Serv. (Callaghan) 648 (Mo. Ct. App. 1973) (not permitting recovery).

47. U.C.C. § 2-313 Official Comments 3, 8.

48. *See* Uniform Revised Sales Act comment on § 37, at 144, 147 (Proposed Final Draft No. 1 (1944)) [hereinafter Proposed Final Draft No. 1], *reprinted in* 2 ALI & NCCUSL, Uniform Commercial Code Drafts 156, 159 (1984) [hereinafter U.C.C. Drafts]. *See also* 2 W. Hawkland, Uniform Commercial Code Series § 2-313:05 (1984); J. White & R. Summers, *supra* note 27, at

Kirby Forest Industries v. Dobbs seems contrary to this presumption of reliance analysis. In that case, an assignee of a timber deed containing an express warranty of title sued, inter alia, for breach of that express warranty. In dictum, the Texas Court of Appeals declared the assignee could not recover on this theory because it had failed to introduce evidence proving that the express warranty in the timber deed had been part of the basis of the bargain between the grantor and the grantee-assignor.[49] Under the analysis developed above, it would seem that the grantor (whom the assignee was suing) had the burden of proving that the grantee could not reasonably have relied upon the warranty. The ruling was harmless, however, because the court affirmed judgment for the assignee of another ground.

A seller has several ways to rebut the presumption of reliance. First, an examination of the goods by the buyer before he closes the deal may establish that he did not rely on the seller's affirmation.[50] Second, the seller may prove that the affirmation is merely one of value, opinion, or commendation.[51] Presumably the seller does this when he shows that both he and the buyer knew that the seller had no actual or apparent basis for making the affirmation. An example of this would be a statement about the failure rate of experimental goods not yet produced.[52] Third, the seller may prove that the buyer was never aware of the affirmation.[53] In all of these instances the seller is doing no more than demonstrating that the buyer did not reasonably rely upon the seller's affirmations.

Under U.C.C. section 2-314, courts continue to find that an implied warranty of merchantability can accompany a sale of used goods.[54]

400. *See generally* Special Project, *Article Two Warranties in Commercial Transactions,* 64 Cornell L. Rev. 30, 50–67 (1978).

49. 743 S.W.2d 348, 355, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1321, 1326 (Tex. Ct. App. 1987). *See* text accompanying notes 41–44, *supra.*

50. *See* Proposed Final Draft No. 1, *supra* note 48, comment on § 37, at 144, *reprinted in* 2 U.C.C. Drafts, *supra* note 48, at 156.

51. *Cf. id.* at 147, *reprinted in* 2 U.C.C. Drafts, *supra* note 48, at 159.

52. St. Charles Cable TV, Inc. v. Eagle Comtronics, Inc., 687 F. Supp. 820, 829, 6 U.C.C. Rep. Serv. 2d (Callaghan) 659, 670–71 (S.D.N.Y. 1988) (alleged statement by seller that expected failure rate for experimental cable TV channel descrambler not yet produced would be less than four percent held not part of basis of bargain). *See generally* Special Project, *supra* note 48, at 65, 172.

53. *See* DiIenno v. Libbey Glass Div., Owens-Illinois, Inc., 668 F. Supp. 373, 4 U.C.C. Rep. Serv. 2d (Callaghan) 706, 709 (D. Del. 1987) (court dismissed personal injury claim for breach of express warranty based on illustration in manufacturer's catalogue for lack of evidence that injured party ever saw catalogue).

54. Fitzner Pontiac-Buick-Cadillac, Inc. v. Smith, 523 So. 2d 324, 6 U.C.C. Rep. Serv. 2d (Callaghan) 396 (Miss. 1988) (used automobile); Fernandes v. Union Bookbinding Co., 400 Mass. 27, 507 N.E.2d 728, 5 U.C.C. Rep. Serv. 2d (Callaghan) 959 (1987) (used die press); Beck Enters., Inc. v. Hester, 512 So. 2d 672, 4 U.C.C. Rep. Serv. 2d (Callaghan) 59 (Miss. 1987) (used truck). The drafting history of § 2-314 demonstrates that the implied warranty of merchantability can attach to the sale of used goods. At one point the draft of what became article 2 provided that "all implied warranties are excluded by the offering of goods for sale as used goods." Uniform Commercial Code—Revised Uniform Sales Act § 41(5) (3d Draft 1943). This phrase disappears in

In *Travis v. Washington Horse Breeders Association*,[55] the Washington Supreme Court, apparently in dictum,[56] indicated that an auctioneer known by a purchaser to be selling the goods of others makes an implied warranty of merchantability to that purchaser when it sells goods at auction. In that case, Travis purchased for $25,000 a colt owned by Northwest Farms (the owner) at a yearling auction conducted by Washington Horse Breeders Association (the auctioneer). Subsequently the purchaser's veterinarian detected a loud heart murmur which rendered the colt unfit for racing or breeding. The purchaser sued both the owner and the auctioneer for, inter alia, breach of the implied warranty of merchantability, seeking rescission of the contract and return of the purchase price.[57] In the course of its discussion of the implied warranty of merchantability, the Washington Supreme Court indicated that the auctioneer had made such a warranty to the purchaser.[58] The court assumed throughout its opinion that the auctioneer was a "seller." It also found the auctioneer to be a "merchant" and then said the auctioneer "is held to the warranty rules set forth in the U.C.C.,"[59] citing an Alabama case. Although the auctioneer here was clearly a merchant, one may question whether it was the "seller" of the colt.[60] Generally, a seller is one who has title to the goods conveyed to the buyer.[61] Here the auctioneer did not have title, and therefore, it could not have been a seller. Since one must be a seller to make an implied warranty of merchantability under U.C.C. section 2-314, the auctioneer could not be held to such warranty. Although that section does not foreclose the possibility of an implied warranty of merchantability in non-sales transactions,[62] the case law

later drafts. Official Comment 3 to § 2-314 now explicitly assumes that the implied merchantability warranty can arise from the sale of used goods.

55. 111 Wash. 2d 396, 759 P.2d 418, 6 U.C.C. Rep. Serv. 2d (Callaghan) 1093 (1988).

56. The court's conclusion that the auctioneer made an implied warranty of merchantability to the purchaser apparently was dictum because the auctioneer appears not to have disputed that such a warranty could be implied. Instead, it argued that any such warranty, if made, had been disclaimed. *See* 47 Wash. App. 361, 734 P.2d 956, 3 U.C.C. Rep. Serv. 2d (Callaghan) 975 (Wash. Ct. App. 1987), *rev'd in part and remanded,* 111 Wash. 2d 396, 759 P.2d 418, 6 U.C.C. Rep. Serv. 2d (Callaghan) 1093 (1988).

57. The purchaser also made claims for breach of express warranty, breach of implied warranty of fitness, mutual mistake, and violation of the Washington Consumer Protection Act (Wash. Rev. Code Ann. § 19.86 (1989)). A judgment for the purchaser on all but one of these claims was twice affirmed on appeal, 47 Wash. App. 361, 734 P.2d 956, 3 U.C.C. Rep. Serv. 2d (Callaghan) 975 (Wash. Ct. App. 1987); *aff'd in part, rev'd in part,* 111 Wash. 2d 396, 759 P.2d 418, 6 U.C.C. Rep. Serv. 2d (Callaghan) 1093 (1988). As to the remaining claim for breach of implied warranty of fitness, the Washington Supreme Court reversed and remanded for the lower court to consider the effectiveness of a warranty disclaimer in the auction sale catalogue.

58. 111 Wash. 2d at 401, 759 P.2d at 420–21, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 1097.

59. *Id.*

60. *See* U.C.C. § 2-104(1).

61. *See* U.C.C. § 2-103(1)(d) (" 'Seller' " means a person who sells or contracts to sell goods."); *id.* § 2-106(1) ("A 'sale' consists in the passing of title from the seller to the buyer for a price (Section 2-401)"); *cf. id.* § 2-401(1) (stating "title to goods passes from the seller to the buyer . . . ").

62. *See* U.C.C. § 2-313 Official Comment 2 (U.C.C. warranty sections not designed to limit warranties to sales transactions).

does not support the proposition that auctioneers generally make these implied warranties.[63] Further, the Alabama case[64] relied upon by the court does not hold that an auctioneer makes the implied warranty of merchantability. Rather, it found that the owner of cattle sold at auction by a merchant auctioneer makes such a warranty. Moreover, unless the auctioneer is auctioning its own goods (and is thus a "seller") or unless it makes an express warranty on its own behalf, the auctioneer should generally not be held to warrant the merchantability of what it sells, even if it is a merchant. The reason for this is that the auctioneer who sells for others acts merely as an agent. Therefore, the auctioneer should not be personally liable on the contract of sale, including any warranties encompassed therein, unless it is liable under agency law.[65] Under agency law, an agent is generally personally liable on a contract made for its principal only when the principal is undisclosed or partially disclosed.[66] In *Travis,* the buyer not only knew who the principal was but also obtained an express warranty from it. Thus, the auctioneer in *Travis* should not have been held liable on the implied warranty of merchantability claim. The buyer's claim that goods sold are not merchantable is against the owner of the goods sold, not the auctioneer.[67]

Several courts have decided that an ordinary use of goods cannot constitute a "particular purpose" in order to establish an implied warranty of fitness for particular purpose under U.C.C. section 2-315.[68]

63. Case law is surprisingly sparse, perhaps because auctioneers are careful to disclaim implied warranties at time of sale. Research uncovered only one case finding that auctioneers who regularly sell particular goods make implied warranties of merchantability as to those goods, and that finding was dictum. *See* Regan Purchase & Sales Corp. v. Primavera, 328 N.Y.S.2d 490, 492, 10 U.C.C. Rep. Serv. (Callaghan) 300, 302 (N.Y. Civ. Ct. 1972). In several cases the trial court granted judgment for the auctioneer on an implied merchantability warranty claim, and that judgment was not appealed. Vince v. Broome, 443 So. 2d 23, 37 U.C.C. Rep. Serv. (Callaghan) 1498 (Miss. 1983); Bemidji Sales Barn, Inc. v. Chatfield, 312 Minn. 11, 250 N.W.2d 185, 20 U.C.C. Rep. Serv. (Callaghan) 1137 (1977).

64. Bradford v. Northwest Ala. Livestock Ass'n, 379 So. 2d 609, 28 U.C.C. Rep. Serv. (Callaghan) 1009 (Ala. Civ. App. 1980).

65. *Cf.* U.C.C. § 1-103 (Code supplemented by law of principal and agent, unless displaced by particular provisions of Code).

66. Restatement (Second) of Agency § 321 illustration 5 (1958) (agent for partially disclosed principal is a party to contract). The agency theory described in the text was adopted by at least two pre-Code cases: Barrett v. Rumeliote, 256 Iowa 1, 126 N.W.2d 322 (1964); Goltz v. Humboldt Livestock Auction Inc., 255 Iowa 1384, 125 N.W.2d 773 (1964); *see also* 3 R. Anderson, Uniform Commercial Code §§ 2-314:136, :137 (3d ed. 1983).

67. Even where the owner is not itself a merchant and therefore would not normally make the implied merchantability warranty, at least one court has found that the owner's employment of an auctioneer who is also a merchant causes the owner to make the implied merchantability warranty to the purchaser. *Bradford,* 379 So. 2d at 611, 28 U.C.C. Rep. Serv. (Callaghan) at 1013.

68. Duford v. Sears Roebuck & Co., 833 F.2d 407, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1374 (1st Cir. 1987) (applying New Hampshire law); Fernandes v. Union Bookbinding Co., 400 Mass. 27, 507 N.E.2d 728, 5 U.C.C. Rep. Serv. 2d (Callaghan) 959 (1987); *cf.* Dilenno v. Libbey Glass Division, Owens-Illinois, Inc., 668 F. Supp. 373, 4 U.C.C. Rep. Serv. 2d (Callaghan) 706, 710 (D. Del. 1987). There is a split of authority on whether an ordinary use of goods can constitute a

Virtually everyone knows that "as is" disclaimers are an effective way of excluding the implied warranties of merchantability and fitness for a particular purpose.[69] The "as is" disclaimer is effective "unless the circumstances indicate otherwise."[70] In several instances courts may tend to find that the circumstances indicate otherwise: (i) The "as is" disclaimer is not conspicuous;[71] (ii) the phrase "as is" is not commonly known by persons in the buyer's position (e.g., a consumer) to exclude warranties;[72] (iii) other terms of the contract and surrounding circumstances such as prior course of dealing indicate that the parties did not intend the "as is" phrase to exclude all warranties.[73] How much leeway the courts will permit a buyer to overcome an "as is" clause by proving that circumstances indicate otherwise depends upon the facts of each case. Thus, for example, in *Nick Mikalacki Construction Co. v. M.J.L. Truck Sales,*[74] where the buyer (Mikalacki) clearly was aware of the clause and its effect, an Ohio appellate court accorded no leeway. In that case, the buyer purchased a used dump truck which had been advertised as having a rebuilt engine. The contract contained an "as is" disclaimer which had been separately acknowledged by the

"particular purpose" under U.C.C. § 2-315. For cases see B. Clark & C. Smith, The Law of Product Warranties § 6.02[2] nn.26, 27 (1984 & Supp. 1988).

69. U.C.C. § 2-316(3)(a) provides:

> (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty . . . .

70. *Id.* The drafting history shows that the "unless circumstances indicate otherwise" phrase was added for clarification and to meet criticism by the New York Law Revision Commission. *See* ALI & NCCUSL, 1956 Recommendations of the Editorial Board for the Uniform Commercial Code 39–40, *reprinted in* 18 U.C.C. Drafts, *supra* note 48, at 63–64 (1984). The commission's criticism was that the subsection as then written "could be read as meaning that the quoted phrases are terms of art that necessarily exclude all implied warranties, without regard to actual understanding in the trade." N.Y. State Law Revision Comm'n, Report and Appendices Relating to the U.C.C. 377 (1956); *see also* 1 N.Y. State Law Revision Comm'n, 1955 Report 409 (1955). The commission recommended that the phrase "is generally understood by buyers of such commodities to exclude implied warranties" be added to meet its criticism. The Enlarged Editorial Board's Subcommittee on Article 2 rejected this recommendation for the reason that it "would cast unnecessary doubt on well-understood meanings." *See* Comment on Criticisms of Article 2 Uniform Commercial Code (Report No. 4 of the Subcommittee on Article 2) 50–51 (1955). The subcommittee offered the "circumstances indicate otherwise" language because "the Code may well be subject to the unintended interpretation that the phrases quoted [in the subsection] always and necessarily exclude all implied warranties." *Id.* at 50.

71. Fernandez v. Western Railroad Builders, 122 Idaho 907, 736 P.2d 1361, 5 U.C.C. Rep. Serv. 2d (Callaghan) 347 (Idaho Ct. App. 1987). *See also* 3 R. Anderson, *supra* note 66, § 2-316:72; J. White & R. Summers, *supra* note 27, at 507–08. "Conspicuous" is defined in U.C.C. § 1-201(10).

72. J. White & R. Summers, *supra* note 27, at 505–06. This is supported by the subsection's drafting history, *see supra* note 70. *But see* cases cited in J. White & R. Summers, *supra* note 27, at 506 n.7.

73. Gindy Mfg. Corp. v. Cardinale Trucking Corp., 111 N.J. Super. 383, 268 A.2d 345, 7 U.C.C. Rep. Serv. (Callaghan) 1257 (N.J. Super. Ct. Law Div. 1970).

74. 33 Ohio App. 3d 228, 515 N.E.2d 24, 5 U.C.C. Rep. Serv. 2d (Callaghan) 69 (1986).

buyer.[75] Shortly after the sale, the truck developed engine trouble. The buyer sued for breach of express and implied warranties, and the seller moved for summary judgment.

The trial court granted the motion. On appeal the buyer argued that since it had understood the clause "as is" to mean that it was accepting only the defects in the vehicle of which it had actual knowledge, it had put in issue the effectiveness of the disclaimer as to latent defects. The court rejected this argument and affirmed the summary judgment for the seller. It reasoned that the buyer had not brought itself within any previously recognized instances of circumstances inconsistent with the "as is" disclaimer. The court further indicated that the interpretation of the "as is" clause in this contract was clear and unambiguous and was therefore a question of law for the court to resolve. One judge, however, dissented. He saw the seller's representation that the truck's engine had been rebuilt as a circumstance inconsistent with the "as is" disclaimer. In his view, a buyer in these circumstances would not have any reason to know that it was waiving warranties covering the engine.

U.C.C. section 2-318 concerns who may sue for breach of warranty, express or implied.[76] It is based on the theory that certain classes of persons described in the section who suffer certain kinds of described injuries are third party beneficiaries of express and implied warranties given by seller to buyer. Official Comment 1 to that section indicates that the seller remains free to both exclude or disclaim warranties under section 2-316 and to limit the remedies for breach of those warranties under sections 2-718 or 2-719. This is consistent with the third party beneficiary theory reflected in section 2-319. The third party beneficiary's rights arise because the parties to the underlying contract have intended to create those rights.[77] Thus, the beneficiary's rights derive from the underlying contract, and consequently, if there is a warranty disclaimer or remedy limitation, or if the circumstances exclude warranties in the underlying contract, the third party's rights are similarly restricted.[78] Despite this, authority is split on whether a disclaimer or remedy limitation effective against the buyer is effective against the third party beneficiary under section 2-318.[79]

75. The relevant contract language was: "Sold 'As Is' I hereby make this purchase and accept this Used Truck knowingly without any warranty whatsoever, express or implied by our Co. or its agents." 33 Ohio App. 3d at 228, 515 N.E.2d at 25, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 70.

76. The 1987 Official Text version of U.C.C. § 2-318 contains three alternative drafts of that section. For a brief discussion of why alternative drafts were recommended, see Report No. 3 of the Permanent Editorial Board for the Uniform Commercial Code 13–14 (1967).

77. Restatement (Second) of Contracts ch. 14 introductory note, at 439 (1981); *id.* § 304 comment b, at 448.

78. 3 R. Anderson, *supra* note 66, § 2:318.9, at 406–07.

79. The case law is collected and briefly described in Patty Precision Prods. Co. v. Brown & Sharpe Mfg. Co., 846 F.2d 1247, 1257, 6 U.C.C. Rep. Serv. 2d (Callaghan) 692, 707–08 (10th Cir. 1988) (Logan, J., concurring).

PERFORMANCE

Title, Creditors, and Good Faith Purchasers

Several interesting cases on the application of the entrustment provision of U.C.C. section 2-403 were reported this year. First, consider *Canterra Petroleum, Inc. v. Western Drilling & Mining Supply.*[80] Oil field pipe originally owned by Mitchell Energy Corporation ("Mitchell") was entrusted to Port Pipe Terminal, Inc. ("Port Pipe") for storage. The culprits in this story, two high-ranking employees of Port Pipe, fraudulently transferred apparent ownership of the pipe to Pharoah, Inc. ("Pharoah"), a sham corporation created by the employees to fraudulently dispose of goods stored with Port Pipe. Pharoah sold the pipe to Nickel Supply Company, Inc. ("Nickel"), which sold it to Yamin Oil Supply ("Yamin"), which sold it to NorthStar Equipment Corporation ("NorthStar"), which sold it to Western Drilling & Mining Supply ("Western"), which sold it to Canterra Petroleum, Inc. ("Canterra"). All of these transactions were paper transactions only. The pipe did not leave Port Pipe's storage facility until delivered to a trucking firm by Canterra. When Canterra learned what had happened, it returned the pipe to Mitchell. This multi-party litigation ensued. Canterra sued Western for breach of warranty of title. Western commenced a third-party action against NorthStar for breach of warranty of title, and NorthStar commenced a fourth-party action against Yamin. The trial court granted each complaining party's motion for summary judgment.

On an appeal by NorthStar, the North Dakota Supreme Court reversed. The court had to contend with NorthStar's argument that, as a consequence of U.C.C. section 2-403(2),[81] Nickel received good title to the pipe as did everyone thereafter.[82] The trial court had decided, on the basis of affidavits, that the entrustment provision was inapplicable because, as a matter of law, Port Pipe was not a "merchant who deals in goods of that kind."[83] The state supreme court held that the determinative standard was whether Port Pipe "engaged regularly in selling goods of the kind"[84] and that conclusory affidavits of the type presented were not dispositive of the issue, especially where, as here, they contained an admission that "Port Pipe did sell small quantities of pipe from time to time, to clear odd lots, or to sell that pipe remaining after a substantial portion of a lot was sold."[85] Summary judgment was, therefore, inappropriate.

80. 418 N.W.2d 267, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1002 (N.D. 1987).

81. U.C.C. § 2-403(2) provides: "Any 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."

82. Once one party in the chain of sale receives good title, the "shelter" principle in U.C.C. § 2-403(1) would insure good title to all subsequent buyers.

83. Notice that one who may be a merchant for other purposes under the Code, *see* U.C.C. § 2-104(1), is not necessarily a merchant with the power to transfer the title of the entruster under U.C.C. § 2-403(2).

84. 418 N.W.2d at 271, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1005.

85. *Id.*

It would seem, however, that even if the requisite merchant status can be shown, to prevail, NorthStar should also be required to show that Mitchell knew of that status at the time of the entrustment.[86]

The second and more interesting aspect of the case was the fact that the pipe had been sold not by the entrustee, Port Pipe, but by the dummy corporation, Pharoah. Relying on the policy of U.C.C. section 2-403(2) rather than its terms,[87] the court could see no reason for not extending its umbrella of protection where the guilty were not outside parties but were the entrustee's employees.

Lest one forget that section 2-403(2) will not always empower the merchant to transfer clear title to a buyer in ordinary courts, *Barth v. Protetch*[88] serves as a convenient reminder. Where plaintiffs were joint owners of a painting with an understanding that it would not be sold except upon mutual consent, its entrustment by one did not give the merchant the power to transfer the title of the other.[89] The opinion does not mention just what rights the plaintiffs have against the ultimate purchaser. Presumably, the merchant did have the power to transfer the entruster's one-half interest in the painting. This would suggest that the entruster has no claim and that the non-entruster has simply a new co-owner.

With the proliferation of commercial statutes external to the Code comes the increasingly frequent task of either harmonizing the two sources of law or, if the two are irreconcilable, deciding which is preemptive of the other. In *Dugdale of Nebraska, Inc. v. First State Bank,*[90] the Nebraska Supreme Court thought harmonization the better alternative. The buyer had purchased and taken possession of a new car but had never received from the dealer the manufacturer's certificate of origin. The reason for the dealer's dereliction was that it had previously delivered the certificate to the bank pursuant to the terms of a loan and security agreement covering the car. When the dealer defaulted, the bank claimed the car. The trial court, relying on Nebraska's certificate of title statute,[91] held that the bank and not the buyer had title.

86. *See, e.g.,* Atlas Auto Rental Corp. v. Weisberg, 54 Misc. 2d 168, 281 N.Y.S.2d 400, 4 U.C.C. Rep Serv. (Callaghan) 572 (N.Y. Civ. Ct. 1967) (entruster must have knowledge of entrustee's status). *See also* Leary & Sperling, *The Outer Limits of Entrusting,* 35 Ark. L. Rev. 50, 83–85 (1981).

87. The court expressed the policy of U.C.C. § 2-403(2) in the following terms: "By favoring the innocent third party, the Uniform Commercial Code endeavors to promote the flow of commerce by placing the burden of ascertaining and preventing fraudulent transactions on the one in the best position to prevent them, the original seller." 418 N.W.2d at 273, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1009 (citing 3 R. Anderson, *supra* note 66, § 2-403:4 (quoting Sacks v. State, 172 Ind. App. 185, 360 N.E.2d 21 (Ind. Ct. App. 1977))).

88. 5 U.C.C. Rep. Serv. 2d (Callaghan) 1350 (N.Y. Sup. Ct. 1987).

89. The court also noted that the non-entruster was not estopped from asserting her rights in the painting since she never authorized her co-owner or any other third party to transfer her interest. *Id.* at 1353–54.

90. 227 Neb. 729, 420 N.W.2d 273, 6 U.C.C. Rep. Serv. 2d (Callaghan) 111 (1988).

91. Neb. Rev. Stat. § 60-105 (1984) provides in pertinent part:

On appeal, the state supreme court reversed. The court acknowledged a long line of past decisions holding that the certificate of title is the exclusive means of transferring ownership, but it distinguished this case on the ground that the dispute was between a purchaser and a dealer's financier. Why this difference matters is unclear. The court placed great reliance on the dealer's warranty of title under U.C.C. section 2-312 and assumed that under section 2-403 the warranty was binding on the bank. But the dealer's warranty in no way affects the buyer's title. Whether a warranty is given or disclaimed is relevant only to the seller's responsibility if, under the controlling law, the title transferred turns out to be defective. Next, the court was struck by what it perceived to be an absurd result of reading the title statute as preemptive of section 2-403. If the buyer obtained no interest because it did not receive the necessary title papers, the bank too obtained no interest because it never possessed the car. What the court overlooked was that the bank's interest was a security interest which was no doubt obtainable without possession. For this reason also, the relevant Code section would appear to be section 9-307(1),[92] not section 2-403(2).

One more word from the Nebraska Supreme Court. In *Worley v. Schaefer*,[93] a tort case involving an issue of insurance coverage, the court held that where the title statute and the Code conflict on the passage of title, the Code controls, at least for purposes of tort law and liability insurance coverage.

Certificate of title legislation, because of its pervasiveness, produces most, but by no means all, of the cases in this area. In *In re Wegner*,[94] the Ninth Circuit held that to the extent Montana law required a bill of sale to transfer title to livestock, the state law superseded the Code. On the other hand, in *In re Gull Air, Inc.*,[95] a bankruptcy court held that compliance with the Federal Aviation Act of 1958 was not a prerequisite to the passage of title to an aircraft. The prescription that the instrument of conveyance must be recorded with the Federal Aviation Administration is for the protection of innocent third parties only.

Tender, Cure, and Notice

The Code clearly bestows upon a seller the limited right to cure a defective tender after rejection by the buyer.[96] This year the Mississippi Supreme Court considered whether a seller has a right to cure following a revocation of

> No person . . . acquiring a motor vehicle . . . shall acquire any right, title, claim, or interest in or to such motor vehicle . . . until he shall have had delivered to him physical possession of such motor vehicle . . . and a certificate of title or a manufacturer's or importer's certificate . . . . No court in any case at law or in equity shall recognize the right, title, claim, or interest of any person in or to any motor vehicle . . . unless there is compliance with this section.

92. *See* U.C.C. § 9-307(1) ("A buyer in ordinary course of business . . . takes free of a security interest created by his seller . . . .").

93. 228 Neb. 484, 423 N.W.2d 748, 6 U.C.C. Rep. Serv. 2d (Callaghan) 710 (1988).

94. 839 F.2d 533, 5 U.C.C. Rep. Serv. 2d (Callaghan) 996 (9th Cir. 1988).

95. 73 Bankr. 820, 4 U.C.C. Rep. Serv. 2d (Callaghan) 466 (Bankr. D. Mass. 1987).

96. *See* U.C.C. §§ 2-508, 2-612(2).

acceptance. The issue is not novel. Numerous courts in the past have confronted it and have generally agreed that in most circumstances the right to cure is lost once acceptance has occurred.[97] The Mississippi court decided otherwise in *Fitzner Pontiac-Buick-Cadillac, Inc. v. Smith,*[98] holding that the buyer of an automobile that had been plagued with infirmities since its purchase could not revoke unless the seller was first afforded an opportunity to cure.

Undaunted by the reality that neither the language of the Code nor the weight of authority sanction this extension of the right to cure, the court reasoned that its holding was justified by the general policy of the law favoring the prevention of economic waste. This policy, said the court, "strongly supports recognition of a reasonable right to cure."[99] In an attempt at further justification, the court added that nothing in section 2-608[100] commands a contrary conclusion. Although it is technically true that section 2-608 does not directly address the applicability of the seller's cure to a revocation situation, the court seems to neglect the importance of the language of section 2-508 in this regard. That provision clearly limits the seller's right of cure to a rejected tender.

Several courts this year emphasized the importance of the buyer's status in defining the standard of compliance necessary to satisfy the notice requirements of 2-607(3)(a).[101] *Titan Trading, Inc. v. Roof Systems, Inc.*[102] and *Stamper Black Hills Gold Jewelry, Inc. v. Souther*[103] demonstrate the willingness of some courts to follow the lead of the Code comments and hold merchant buyers to a heightened standard of timely and adequate notice.[104] In each case, the standard

97. *See, e.g.,* Bonebrake v. Cox, 499 F.2d 951, 14 U.C.C. Rep. Serv. (Callaghan) 1318 (8th Cir. 1974); American Honda Motor Co., v. Boyd, 475 So. 2d 835, 41 U.C.C. Rep. Serv. (Callaghan) 410 (Ala. 1985); Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65, 35 U.C.C. Rep. Serv. (Callaghan) 804 (1983); Gappelberg v. Landrum, 666 S.W.2d 88, 37 U.C.C. Rep. Serv. (Callaghan) 1563 (Tex. 1984). *See also* 1 J. White & R. Summers, *supra* note 27, at 424; Note, *Revocation of Acceptance: The Seller's Right to Cure After* Gappelberg v. Landrum, 38 Baylor L. Rev. 441 (1986).

98. 523 So. 2d 324, 6 U.C.C. Rep. Serv. 2d (Callaghan) 396 (Miss. 1988).

99. *Id.* at 328 n.1, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 401 n.1.

100. U.C.C. § 2-608 governs the buyer's right of revocation.

101. U.C.C. § 2-607(3)(a) requires that as a prerequisite to pursuit of a remedy for breach, the buyer must "within a reasonable time after he discovers or should have discovered any breach notify the seller of breach."

102. 5 U.C.C. Rep. Serv. 2d (Callaghan) 591 (W.D. Ga. 1987).

103. 414 N.W.2d 601, 5 U.C.C. Rep. Serv. 2d (Callaghan) 340 (N.D. 1987).

104. With regard to timeliness of notice, the official commentary accompanying § 2-607 imposes upon merchant buyers a standard of commercial good faith and notes that this is a more exacting measure than that required of a retail consumer. However, with regard to content of the notice, the standard required of merchants is not explicitly addressed. Comment four generally states: "The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched." But further reading of this comment reveals another, somewhat stricter, standard which requires that the content of the notice "be such as informs the seller that the transaction is claimed to involve a breach." Consistent with the policy of promoting commercial good faith in transactions between merchants, as expressed in the timeliness requirement and throughout the Code generally, courts have read into comment four a distinction in the applicability of the two content standards based on the status of the parties.

of adequacy was defined as one which provides notification to the seller that the buyer intends to treat the alleged nonconformity as a breach. Notice which does no more than apprise the seller that the transaction is "troublesome" is adequate in the case of a consumer buyer, but it will not do for transactions between merchants. Accordingly, the seller's knowledge of the nonconformity does not relieve the merchant buyer of the obligation to give notice of his intent to treat the nonconformity as a breach.[105]

The holding in *McClure Oil Corp. v. Murray Equipment, Inc.*[106] provides a sharp contrast to the courts' reasoning in *Titan* and *Souther.* In *McClure,* the court held that a communication from the manufacturer of defective petroleum pumps to seller Murray Equipment, which informed it that buyer McClure was experiencing difficulties with the pumps, constituted sufficient notice under 2-607(3)(a). The court paid no attention whatever to the merchant status of the buyer. If it had thought it relevant, the mere notification of problems with the equipment would presumably not have constituted adequate notice. Moreover, the court appears to have overlooked any issues raised by the fact that the "notice" which the seller received was not from the buyer but was essentially nothing more than a status report from the manufacturer's troubleshooter. Arguably, the language of 2-607(3)(a) is not broad enough to encompass this kind of third party notice.[107] This would most certainly be true if the *Titan* and *Souther* courts' construction of the section is accepted as accurate.

As a third party beneficiary of a warranty running to his employer, the plaintiff in *Lariviere v. Dayton Safety Ladder Co.*[108] represents a class of buyers to which yet another notice standard applies. The Official Comments accompanying 2-607 relate that notice requirements must be relaxed when applied to a third party beneficiary. All that is necessary is that the plaintiff use "good faith in notifying" the seller after discovery of the breach.[109] In this personal injury suit, the Rhode Island Supreme Court held that a letter from the plaintiff's attorney which informed the immediate seller that "this office has been retained by [plaintiff] to represent him in his claim for personal injuries . . . resulting from . . . your faulty equipment" satisfied plaintiff's section 2-607 responsibilities.[110] The court construed Official Comment 5 to require from a warranty beneficiary only good faith notice of the injury and held that both the timeliness

105. In *Souther,* the North Dakota Supreme Court held that the trial court erred in concluding that the requirements of § 2-607 are inapplicable to a breach caused by late delivery. The trial court reasoned that "it would be unreasonable, if not absurd" to require notice when the seller is already aware of its failure to make timely delivery. This reasoning overlooks the extent of the buyer's obligation. Compliance with § 2-607 not only entails notice of the existence of a nonconformity but also requires notice of the buyer's intent to treat the nonconformity as a breach.

106. 515 N.E.2d 546, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1354 (Ind. Ct. App. 1987).

107. The language of § 2-607(3)(a) requires that the buyer notify the seller.

108. 525 A.2d 892, 4 U.C.C. Rep. Serv. 2d (Callaghan) 433 (R.I. 1987).

109. *See* U.C.C. § 2-607 Official Comment 5.

110. 525 A.2d at 898, 4 U.C.C. Rep. Serv. (Callaghan) at 442.

and the content of the plaintiff's notice in this case were adequate to meet this standard.[111]

Risk of Loss

Using a risk of loss case as its vehicle, the Oklahoma Court of Appeals this year demonstrated that it is possible to arrive at the proper disposition of an issue despite a failure to identify and apply the relevant Code provision. In *Ron Mead T.V. & Appliance v. Legendary Homes, Inc.,*[112] the plaintiff sought payment for household appliances ordered by the defendant home builder. The plaintiff had delivered the goods to the buyer's unattended home construction site after working hours, placing them in a garage on the premises and locking the door. During the night the appliances were stolen. The buyer refused to pay the purchase price, claiming that the risk of loss was still with the seller at the time of the theft. Citing section 2-509(3),[113] the trial court rendered judgment in the buyer's favor, reasoning that the risk of loss had not passed to the buyer because it had not yet received[114] the goods. In an unsuccessful effort to vindicate the time and manner of its tender, the seller attempted to prove a usage of trade which would permit after-hours delivery to an unattended construction site.[115]

On appeal, the Oklahoma Court of Appeals held that the lower court had not erred in rejecting the seller's trade usage argument because of insufficient evidence. The court of appeals also agreed with the trial court that the risk of loss had not passed because there had been no receipt of the goods by the buyer, inasmuch as receipt requires the taking of physical possession.[116] The court then made a cursory and altogether unconvincing effort to support this holding by stating, in conclusory fashion, without citation, that "placing the goods in an unlocked garage, in a house under construction, and then locking the door did not give the Buyer the opportunity to take physical possession [of them]."[117]

111. The court noted that less is required of a third party beneficiary of a warranty in order to comply with § 2-607(3)(a). Even so, the notice in this case would have probably been sufficient to satisfy even the most stringent standard since it informed the seller of the intent to treat the nonconformity as a breach and was timely sent. Perhaps because plaintiff notified all parties in the chain of distribution, this opinion does not discuss whether notice to remote sellers and manufacturers is required of a third party beneficiary. Courts are divided on this issue. Rhode Island agrees with those jurisdictions which require notice to remote sellers and manufacturers.

112. 746 P.2d 1163, 6 U.C.C. Rep. Serv. 2d (Callaghan) 117 (Okla. Ct. App. 1987). (The discussion of this case was contributed by Diane Modes.)

113. Under U.C.C. § 2-509(3), risk of loss "passes to the buyer on his receipt of the goods if the seller is a merchant."

114. Receipt of goods is defined in U.C.C. § 2-103(1)(c) as "taking physical possession of them."

115. U.C.C. § 2-503 details the criteria which are essential to a proper tender of delivery by a seller. One of these requires that "tender must be at a reasonable hour." U.C.C. § 2-503(1)(a). Official Comment 3 to § 2-503 elaborates upon this requirement, specifying usage of trade and "circumstances of the particular case" as elements which may have relevance in defining a reasonable hour for tender.

116. U.C.C. § 2-103(1)(c).

117. 746 P.2d at 1165, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 119.

Although the court manages to properly conclude that the risk of loss had not passed to the buyer, it does so despite misapplication of the Code's risk of loss provisions. Both the trial court and the court of appeals incorrectly cited section 2-509 as the controlling section. Because of the improper tender by the seller, the risk of loss issue in this case should have been resolved by application of section 2-510(1).[118] Regardless of whether the goods have been received,[119] under section 2-510(1) the buyer does not bear the risk of loss where the tender of delivery is so nonconforming as to give a right of rejection.[120] Once the court resolved in the negative the threshold question of whether the seller had made a conforming tender of delivery, it should have looked to section 2-510 for disposition of the risk of loss issue. It is because of this failure to correctly identify the relevant provision that the court needlessly doomed itself to wrestle with the slippery concept of possession.[121] The court would not have needed to reach this issue if it had recognized section 2-510 as controlling. One must wonder how this case would have ended if, all other things being the same, the court had decided that the buyer had received the goods. In view of the court's apparent ignorance of both section 2-510 and the immateriality of the possession issue, it would seem that, notwithstanding the defective tender, the seller would have wrongly prevailed.

Repudiation

The Code offers no clear guidance as to whether the date of repudiation and the breach date necessarily coincide where the nonrepudiating party chooses, under section 2-610(a), to ignore the repudiation and await performance. There is pre-Code case law holding that an anticipatory repudiation is not a breach

118. U.C.C. § 2-510(1) provides: "Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance."

119. Zabriskie Chevrolet, Inc. v. Smith, 99 N.J. Super. 441, 240 A.2d 195, 5 U.C.C. Rep. Serv. (Callaghan) 30 (N.J. Super. Ct. Law Div. 1968). *Cf.* U.C.C. § 2-602(2)(b).

120. U.C.C. § 2-601 provides broad parameters to a buyer's right of rejection, which may in turn be applied to benefit a buyer attempting to come under the protection of § 2-510(1). Because the risk of loss does not shift to the buyer when the seller's performance is such that the buyer has a right of rejection, the risk therefore will not pass to the buyer when the "goods or the tender of delivery fail in any respect to conform to the contract." U.C.C. § 2-601.

121. *See* R. Nordstrom, Law of Sales § 134 (1970) (discussion of the array of risk of loss problems which are spawned by the difficulty of establishing whether receipt of goods has occurred).

until the aggrieved party elects to treat it as such.[122] At least one commentator has noted that some courts continue to adhere to this view.[123]

In *Energy Cooperative, Inc. v. SOCAP International, Ltd.*,[124] a repudiation case complicated by bankruptcy proceedings, the Seventh Circuit was seemingly oblivious to the existence of any uncertainty surrounding this issue. This case was an attempt by Energy Cooperative, Inc.'s ("ECI" 's) trustee in bankruptcy to recover as a preference a $1.6 million payment made by ECI to SOCAP. The transfer was made as compensation for ECI's repudiation of its contract to purchase oil from SOCAP. The success of the trustee's claim depended on whether the transfer could be characterized as being made "for or on account of an antecedent debt."[125] The court correctly recognized that in order to determine whether this was in fact the case it would be necessary to determine when the debt arose. After an inquiry into the meanings of debt[126] and claim[127] within the context of the Bankruptcy Code, the court concluded that the debt arose at the time that SOCAP acquired a claim against ECI.[128] Relying on section 2-610(b), which allows the aggrieved party to resort to any remedy for breach as soon as repudiation occurs, the court held that SOCAP had a claim for damages immediately upon ECI's repudiation on March 11 and that ECI's debt to SOCAP was incurred coinstantaneously. Hence, the $1.6 million payment on April 16 was a settlement of this antecedent debt.

In determining the crucial issue of when the debt arose, the court based its conclusion on the application of section 2-610(b) without regard to the possible

122. (This section of the survey was contributed by Diane Modes.) *See* 4 A. Corbin, Corbin on Contracts § 981 (1951); 11 S. Williston, A Treatise on the Law of Contracts 1320 (3d ed. 1968). The question of whether the date of repudiation may be distinguished from the date of breach is a variation on the interpretive problems posed by § 2-713, a provision which has engendered considerable confusion. *See, e.g.*, Oloffson v. Coomer, 11 Ill. App. 3d 918, 296 N.E.2d 871 (Ill. App. Ct. 1973).

123. *See* 4 R. Anderson, *supra* note 66, § 2-610:18. *Cf.* Apex Oil Co. v. Belcher Co., 855 F.2d 997, 6 U.C.C. Rep. Serv. 2d (Callaghan) 1025 (2d Cir. 1988); Sawyer Farmers Coop. Ass'n v. Linke, 231 N.W.2d 791, 17 U.C.C. Rep. Serv. (Callaghan) 102 (N.D. 1975).

124. 832 F.2d 997, 5 U.C.C. Rep. Serv. 2d (Callaghan) 99 (text not reprinted) (7th Cir. 1987).

125. 11 U.S.C. § 547(b) (1982). This provision of the Bankruptcy Code allows the trustee in bankruptcy to recover a transfer which meets five specifications. Only § 547(b)(2), requiring that the transfer be "for or on account of an antecedent debt owed by the debtor before such transfer was made," was at issue here.

126. 11 U.S.C. § 101(11) (1982) provides that " 'debt' means liability on a claim."

127. 11 U.S.C. § 101(4) provides:

> (4) "claim" means—
>
> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

128. 832 F.2d at 1001. Legislative history indicates a clear congressional intent that debt and claim be construed synonymously; they differ only in that they represent opposing interests, but in the same obligation. *See In re* Vasu Fabrics, Inc., 39 Bankr. 513, 516–17 (Bankr. S.D.N.Y. 1984).

relevance of the other alternatives which section 2-610 offers the nonrepudiating party. Although a party may immediately resort to its remedies for breach, it may also await performance for a commercially reasonable period of time.[129] SOCAP waited until the performance date to inform ECI that it would be held liable for damages. The timing of this notification raises the possibility that SOCAP chose to exercise its option under section 2-610(a) to await performance rather than to treat the repudiation as a breach. Arguably, this could place the breach, and therefore the acquisition of a right to payment, at the date of performance rather than the repudiation date.

The court in SOCAP simply assumed that the repudiation and the breach coincided. This assumption has no important effect here because the settlement occurred after the performance date had passed. Yet, if the transfer had been made within the time in which the seller might reasonably await performance, it could have been viably asserted that the breach and the settlement occurred simultaneously. This would be possible if the breach were declared at the moment that the settlement was paid. The transfer would not be for or on account of an antecedent debt and would escape recovery by the trustee in bankruptcy.

A party may commit an anticipatory breach by a clear manifestation of unwillingness to perform under the contract.[130] Sometimes, however, circumstances may indicate that one of the parties to a contract will be unable or unwilling to perform as promised, although there has been no unmistakable indication to that effect. The party threatened with the prospect of an impending breach in this situation may, under section 2-609, protect himself by demanding assurance of due performance.[131] If no assurance is forthcoming, then the party failing to respond has repudiated the contract.[132]

An interesting twist on this scenario was played out in *Central Oil Co. v. M/V Lamma Forest*.[133] The seller, Central Oil, had already discharged its obligation under the contract by providing the British ship Lamma Forest with 500 metric tons of fuel oil.[134] The relevant terms of the agreement provided that the fuel must comply with British standards and that payment was to be made within thirty days of delivery. Two weeks after delivery of the oil, Central received notice from the buyer that the oil contained aluminum particles in

129. U.C.C. § 2-610(a).

130. *See* U.C.C. § 2-610 Official Comment 1: "anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance."

131. U.C.C. § 2-609(1).

132. U.C.C. § 2-609(4).

133. 821 F.2d 48, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1012 (1st Cir. 1987).

134. Pre-Code law did not recognize anticipatory repudiation as a breach if the contract was unilateral, regardless of whether it was originally so or was originally a bilateral contract which was made unilateral by the full performance of one party. *See* E. Farnsworth, Contracts § 8.20, at 630 (1982). The Code appears to reject this approach, although it does not do so expressly. *See* R. Hillman, J. McDonnell & S. Nickles, Common Law and Equity Under the Uniform Commercial Code § 8.04[3], at 8-32 (1985).

excess of levels allowed by the British standard and that it therefore considered the fuel to be nonconforming. Central responded with a demand for assurance that payment would be forthcoming. Approximately one week before payment was due, having heard nothing from the Lamma Forest, Central sent a representative to the ship, then docked in Rhode Island, to attempt negotiations. This effort was unavailing. Central then sent another demand, this time not for assurance but for immediate payment. When no response was received, and with six days still remaining in which the buyer might perform, the seller had the Lamma Forest arrested under a maritime lien, based on the Forest's alleged anticipatory repudiation. Central implemented these drastic measures in response to its belief that the ship would soon leave American waters and the jurisdiction of United States courts. In the ensuing suit seeking payment for the fuel oil plus interest, the Lamma Forest counterclaimed, inter alia, for breach of warranty[135] and wrongful arrest. The First Circuit affirmed the decision of the lower court, which held that Central had acted upon a good faith belief that the buyer had repudiated, thereby vitiating the malice needed to prove wrongful arrest.

The seller in this case availed itself of the protection of section 2-609 in a somewhat unusual way. Most commonly, the refuge offered by this provision lies in a justifiably worried party's right to suspend its own performance. Even when as here this recourse is effectively foreclosed by full performance, section 2-609 still offers a valuable benefit in that it allows the aggrieved party to proceed with suit immediately. In *Central,* the seller used the provision as a shield, a foundation for supporting its good faith belief that a repudiation had occurred.[136]

REMEDIES

Rejection and Revocation of Acceptance

Assuming that the circumstances of the tender give the buyer the right of rejection or revocation of acceptance, that right can be lost in any number of ways. In *CPC International, Inc. v. Techni-Chem, Inc.,*[137] the court was faced with several. That case involved the purchase of a system of equipment to process and refine fructose. Despite the seller's intermittent attempts to correct the situation, the buyer continually complained that the system was not meeting the production guarantee. Notwithstanding the buyer's suit for breach of warranty, it continued to use the equipment. With the help of an outside consultant modifications were made to the system, in part, with equipment manufactured by another company. Not until four months after this suit was filed did the buyer send to the seller's counsel the letter which purported to

135. The court disposed of the warranty claim with dispatch, holding that the Lamma Forest failed to shoulder its burden of proof as to acceptable levels of aluminum under the British standard.

136. Query whether the court should have inquired into the reasonableness of the demand as a threshold issue. If the demand was unjustified, then the buyer was not obligated to respond.

137. 660 F. Supp. 1509, 4 U.C.C. Rep. Serv. 2d (Callaghan) 485 (N.D. Ill. 1987).

revoke the buyer's acceptance. Still, the buyer continued to use the system. In its motion for summary judgment the seller argued that the notice of revocation was insufficient, that it came too late, and that the right, if it otherwise existed, was lost as a result of the buyer's continued use of the system and its modification. The district court disagreed.

According to the court, the notice was not insufficient because it did not contain an offer to return the equipment. What was true under prior law is no longer true under the Code.[138] Now, notice of revocation is enough.[139] On the timeliness of the notice, which came sixteen months after delivery, the court thought that in light of the repeated attempts to bring the system into line with the production guarantee the question should be resolved by the trier of fact. Next, the court addressed the issue of post-revocation use. Finding no California case on point, the court adopted what it believed to be the better reasoned view. It sensibly ruled that use should not be absolutely prohibited where doing so would unreasonably increase the buyer's damages.[140] Finally, it was also for the trier of fact to decide whether the modification of the system was necessitated by the system's own defects.[141]

Not all courts this year have tackled the issue of post-revocation use with the same degree of pragmatism as the court in the *Techni-Chem* case. *Fiat Auto U.S.A., Inc. v. Hollums*[142] is a good example of the type of mechanical reasoning rejected in *Techni-Chem*. Following his letter to the manufacturer asking it to take back the car, the buyer of the car repaired it, painted it, paid taxes on it, insured it, tried to sell it, and drove it over 6,000 miles. Completely ignoring the buyer's contention that his conduct was necessary to cut his losses, the court held that he had reaccepted the car as a matter of law.[143] Therefore, the trial court erred in not granting a directed verdict on the issue of revocation.[144]

138. Under former California Civil Code § 1789(3), the forerunner to U.C.C. § 2-608, the buyer's right to rescind was predicated upon the return or an offer to return the goods to the seller. *See* Cal. Com. Code § 2608 comment 5 (West 1984).

139. Because notice of breach is mandated even if buyer wishes to retain the goods, the notice of rejection or revocation must do more than let the seller know that there is a problem with the goods. *See* McClure Oil Corp. v. Murray Equip., Inc. 515 N.E.2d 546, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1354 (Ind. Ct. App. 1987) (letter indicating only that buyer was having problems with the goods was an insufficient notice of rejection).

140. As the court put it, "The better reasoned cases stress that 'avoidance of an absolute rule against continued use is counseled by the overriding requirement of reasonableness which permeates' the Uniform Commercial Code." 660 F. Supp. at 1515, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 489 (citing Fablok Mills, Inc. v. Cocker Mach. & Foundry Co., 310 A.2d 491, 494, 13 U.C.C. Rep. Serv. (Callaghan) 449, 454 (N.J. Super. Ct. App. Div. 1973)).

141. This issue is made relevant by U.C.C. § 2-608(2) ("Revocation . . . must occur . . . before any substantial change in condition of the goods which is not caused by their own defects.").

142. 363 S.E.2d 312, 5 U.C.C. Rep. Serv. 2d (Callaghan) 969 (Ga. Ct. App. 1987).

143. The court's analysis consists of no more than the following quotation from U.C.C. § 2-606(1)(c) Official Comment 4: "[A]ny action taken by the buyer, which is inconsistent with his claim that he rejected the goods, constitutes an acceptance." 363 S.E.2d at 315, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 972.

144. The court could have avoided the issue of post-revocation use had it rested its decision on the absence of contractual privity between the parties. Curiously, no mention is made of the

Regardless of how critical the goods are to the buyer's business, rejection will not be permitted where post-revocation use makes their return to the seller impossible. In *J.L. Clark Manufacturing Co. v. Gold Bond Pharmaceutical Corp.,*[145] the buyer purchased metal containers for the packaging of its product, pharmaceutical powder. After the containers were supposedly rejected, the buyer continued to use them in its production process. The district court held that such use constituted reacceptance as a matter of law. The court was probably correct. However, in this case, there would be little difference in net result if rejection were permitted and the court imposed an obligation on the buyer to account to the seller for the use value of the goods.[146]

To conclude, one other case merits a brief word. Does *Advanced Computer Sales v. Sizemore*[147] stand for the dubious proposition that although breach of warranty may be a sufficient prerequisite to revocation, it is never a necessary one? The court does state that "[section 2-608] is an available remedy even where the seller has attempted to limit its warranties,"[148] but the very next sentence—"[w]here circumstances cause an exclusive or limited remedy to fail of its purpose, remedy may be had as provided in the commercial code"[149]—is plucked almost verbatim from U.C.C. section 2-719. By failing to distinguish adequately between two distinct concepts, the court has considerably weakened our understanding of the case.

Impracticability

The drafting history of subsection 2-615(a)[150] suggests that it was intended to apply to unforeseen events occurring after the contract was made.[151] The drafters appear not to have considered foreseeability of the event, which is so popular with courts, as a test. A seller seeking excuse for an event unforeseen at the time of contracting satisfies the "failure of basic assumption" test, if (i) the

overwhelming majority of cases which have held that the remedy of revocation is available only against the buyer's immediate seller. *See* Frisch & Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title,* 43 Bus. Law. 1259, 1288 n.176 (1988).

145. 669 F. Supp. 40, 5 U.C.C. Rep. Serv. 2d (Callaghan) 93 (D. R.I. 1987).

146. Without a right to reject, the buyer would pay the contract price, *see* U.C.C. 2-709(1)(b), less the diminished value of the goods. *See* U.C.C. § 2-714(2). If permitted to reject and required to pay for use value, the buyer's payment would be approximately the same, i.e., the value of the goods tendered.

147. 366 S.E.2d 303, 6 U.C.C. Rep. Serv. 2d (Callaghan) 18 (Ga. Ct. App. 1988).

148. *Id.* at 305, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 19.

149. *Id.*, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 19.

150. U.C.C. § 2-615 provides in pertinent part:

> Except so far as a seller may have assumed a greater obligation . . . .
>
> (a) Delay in delivery or non-delivery in whole or in part by a seller who complies under paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made . . . .

151. Wladis, *Impracticability As Risk Allocation: The Effect of Changed Circumstances Upon Contract Obligations for the Sale of Goods,* 22 Ga. L. Rev. 503, 571–76 (1988).

seller has not by agreement assumed the risk of the event; (ii) the event directly interferes with an essential part of the seller's performance; (iii) the event affects sellers generally and not just the individual seller; and (iv) the event is beyond the reasonable control of the seller.[152] In many cases the events for which excuse is sought satisfy these requirements. Thus, the focus should be on whether the events have rendered the seller's performance so burdensome as to make it impracticable.[153]

Several 1988 cases provide an opportunity to assess what courts do in section 2-615 cases in light of that section's drafting history. All of these cases concern buyers who sought excuse, but section 2-615 can apply to sellers.[154] The first case is *Florida Power & Light Co. v. Westinghouse Electric Corp.*[155] In that case, Westinghouse Electric Corporation ("Westinghouse") entered into three contracts in 1966 with Florida Power & Light Company ("the utility") in which Westinghouse agreed to construct two nuclear power plants for the utility. Westinghouse also agreed to supply the plants with uranium fuel for ten years and to remove and dispose of spent fuel for a like period. Though at the time they contracted there was virtually no limited fuel reprocessing capacity available, the parties assumed that the spent fuel would be removed to facilities where it would be reprocessed.[156] This assumption was based upon the government's assurance that it would reprocess spent fuel until commercial reprocessing facilities became available, as well as the existence of a developing, if nascent, commercial reprocessing industry. However, by 1975, when Westinghouse was to remove and dispose of spent fuel, no commercial reprocessing facilities existed, nor were there any facilities which could store the spent fuel.[157] Therefore Westinghouse refused to remove the spent fuel from the utility plants' premises, provoking this suit. This case thus concerns a situation in which the parties entered into a contract assuming that certain events would occur (reprocessing facilities would become available) and those events failed to

152. *Id.* at 576–78, 580–82.

153. The view of Karl Llewellyn, Chief Draftsman of the section, was that an increase in the cost of performance of two to three times the normal cost was the threshold of impracticability. *Id.* at 584.

154. Typically, buyers of goods find it more difficult than sellers to be excused from performance for supervening events. Nevertheless, the drafters intended that buyers be covered by U.C.C. § 2-615. *See* U.C.C. § 2-615 Official Comment 9. *See also* Wladis, *supra* note 151, at 504 n.2. Official Comment 9, though it indicates that buyers are not to be treated quite the same as sellers, focuses on events that affect the individual buyer rather than the systemic market failures referred to in Official Comment 4, which discusses seller excuse for increased cost. Thus, even though it might be argued that different considerations distinguish seller excuse from buyer excuse, it is submitted that where systemic market failures affect a contract, the factors to be considered in determining whether or not to excuse are the same whether the party seeking excuse is a seller or a buyer.

155. 826 F.2d 239 (4th Cir.), *cert. denied,* 108 S. Ct. 1574 (1988).

156. Reprocessing involves removing the most valuable and dangerous components, uranium and plutonium, from the spent fuel. These elements can then be recycled into fresh fuel. 826 F.2d at 248–49 (quoting from Nuclear Regulatory Commission order describing reprocessing process).

157. *See* 826 F.2d at 249–51 (describes the reasons why reprocessing of spent fuel fell into disrepute).

occur. Westinghouse defended principally upon the ground of commercial impracticability.[158]

The district court issued three opinions. The first opinion found Westinghouse to have breached its obligation to remove and dispose of the spent fuel but deferred granting a remedy.[159] After this opinion, the Nuclear Waste Policy Act became law in 1983. This act provided for construction of long-term storage facilities for spent fuel as a substitute for reprocessing.[160] Subsequently, the district court issued a second opinion excusing Westinghouse from its obligation to remove and dispose of the fuel and ordering an equitable adjustment of the contract under which Westinghouse was to pay essentially all of the $30 million cost of short-term on-site storage of the fuel until a long-term storage facility became available. The utility was to bear the $70 million expense of long-term storage.[161] In its third opinion,[162] the district court reversed itself and refused to excuse Westinghouse. It split the short-term on-site storage costs between the parties and imposed the long-term storage costs upon Westinghouse. On appeal, the Fourth Circuit affirmed the allocation of short-term storage costs between the parties because that part of the district court's third opinion had not been appealed. However, it reversed the imposition of long-term storage costs upon Westinghouse. This result allocated the $100 million expense of storing the spent fuel as follows: Westinghouse was to pay $18 million; the utility was to pay the remaining $82 million.

The Fourth Circuit reasoned that Westinghouse had established the defense of impracticability on several theories. According to the first theory, Westinghouse had demonstrated that the parties' contemplated method for disposing of spent fuel (reprocessing) was the only possible method of disposal, both when the parties contracted in 1966 and when Westinghouse was to begin to perform in 1975. Furthermore, this sole method of disposal did not exist when Westinghouse was to perform. The court said this was a "textbook illustration" of

158. Westinghouse also asserted several other defenses: (i) common law impossibility, which the district court said was the same as commercial impracticability under the U.C.C., *see* Florida Power & Light Co. v. Westinghouse Elec. Corp. (*In re* Westinghouse Elec. Corp. Uranium Contracts Litig.), 517 F. Supp. 440, 450, 31 U.C.C. Rep. Serv. 2d (Callaghan) 930, 945 (E.D. Va. 1981); (ii) excuse under a contractual force majeure clause; (iii) frustration of purpose; and (iv) mutual mistake. *See* 826 F.2d at 242. Although the district court ruled on each of these defenses, *see* 517 F. Supp. at 450–60, 31 U.C.C. Rep. Serv. 2d (Callaghan) at 945–60, the Fourth Circuit disposed of the case by ruling for Westinghouse on the impracticability/impossibility defense. 826 F.2d at 262.

159. 517 F. Supp. 440, 31 U.C.C. Rep. Serv. (Callaghan) 930 (E.D. Va. 1981).

160. Long-term storage is not an immediate solution because storage facilities will not be available for 10–20 years. Though the Nuclear Waste Policy Act states that such facilities will not be available until at least 1998, *see* 597 F. Supp. at 1472, a realistic date is 2010. 826 F.2d at 277.

161. This opinion is unreported. It is described in the opinion of the Fourth Circuit. *See* 826 F.2d at 257–58.

162. 597 F. Supp. 1456 (E.D. Va. 1984), *aff'd in part, rev'd in part,* 826 F.2d 239 (4th Cir.), *cert. denied,* 108 S. Ct. 1574 (1987).

circumstances warranting application of the impracticability doctrine.[163] According to the second theory, Westinghouse had established that the unavailability of reprocessing facilities was an occurrence which was both unexpected and unforeseeable when the parties contracted; this satisfied the "failure of basic assumption" test.[164] Also, Westinghouse had demonstrated that the lack of reprocessing facilities was beyond its reasonable control.[165] Finally, the lack of reprocessing facilities had rendered Westinghouse's performance impracticable. The court gave two reasons for its conclusion on this point. First, the alternative to reprocessing, long-term storage, had not been possible when Westinghouse was to perform and was not yet possible. Thus it was not an alternative means of performance. Second, even if the court were to consider long-term storage as an alternative to reprocessing, it was not a reasonable alternative. The court stated that, if the cost of long-term storage were imposed on Westinghouse, not only would Westinghouse fail to receive the $18–20 million contemplated profit on the utility fuel disposal contract, the cost to Westinghouse would be well over $80 million. The court found this result to be so excessive and unreasonable as to render Westinghouse's performance impracticable.[166]

A final factor in the Fourth Circuit's decision to excuse Westinghouse was the effect of the decision to excuse or not to excuse upon the parties.[167] The court had previously noted that Westinghouse would have a net loss on all three contracts with the utility even if it were excused from performing the fuel disposal contract.[168] The court noted that the utility would likely be able to pass

163. 826 F.2d at 265. This is not quite so. The cases concerning failure of a contemplated source usually involve a source which existed when the contract was made and which later ceased to exist. *See, e.g.*, cases collected in Wladis, *supra* note 151, at 601–03 ("I. Problems With Plant of Seller or Supplier"), 615–16 ("K. Goods or Supply Source Destroyed, Damaged, or Ceases to Exist"). When the source is one which did not exist when the contract was made and which failed to come into existence, the cases do not grant excuse. *Id.* at 616 ("L. Supply Source Does not Come Into Existence"); *see also id.* at 612 ("G. Technological Impossibility"). Furthermore, if reprocessing was the only means of disposal and was not yet available when the parties made the contract, then the case is one of existing impracticability, for which there is no excuse unless the promisor had no reason to know the facts that affect his performance. Restatement (Second) of Contracts § 266 (1981). Here, Westinghouse clearly knew the relevant facts when it entered the fuel disposal contract.

164. 826 F.2d at 266–74.

165. *Id.* at 274–76.

166. The Fourth Circuit disagreed with the district court's method of determining whether performance was impracticable. *Id.* at 277. The district court had focused on Westinghouse's revenues and costs to perform all three contracts with the utility. In this calculation the cost of long-term storage was only one element. It amounted to 40–45% of total revenues under all the contracts. When this cost was added to Westinghouse's losses on the other two contracts, the total cost would be just under 50% of total contract revenues under all the contracts. The district court held these percentages not to be insufficient for excuse. 597 F. Supp. at 1477–78. The Fourth Circuit criticized the district court's calculation for considering Westinghouse's costs and revenues on the other two contracts. The correct comparison, said the Fourth Circuit, was of costs and profits or revenues for only the fuel disposal contract. 826 F.2d at 277.

167. 826 F.2d at 279.

168. *Id.* at 277.

the cost of fuel disposal onto its ratepayers who were already reaping substantial benefits from cost savings resulting from the utility's switch to nuclear power. It was estimated that the ratepayers would save just under $2 billion in electric costs during the life of Westinghouse's fuel disposal contract, and $8 billion over the expected life of the nuclear plants. In the court's view it was fair to allocate the relatively small cost of fuel disposal against this large saving. Thus, the Fourth Circuit held that Westinghouse should be excused from its obligations under the fuel disposal contract.

Several cases dealt with contracts in which purchasers of natural gas entered into "take-or-pay" contracts with natural gas producers in which the purchasers agreed to take minimum quantities of gas or pay for gas not taken.[169] When the demand for natural gas sagged in the early 1980s,[170] a rash of litigation ensued in which purchasers attempted to evade liability. In one case they were unsuccessful;[171] in the other, they were partially successful.

In the first case, *Golsen v. ONG Western Inc.*,[172] decided by the Oklahoma Supreme Court, the purchaser (ONG) had entered into a fifteen-year take-or-pay contract in September 1981 just before the crisis in the natural gas market developed.[173] When the purchaser failed to take or pay for the minimum contractual quantities the seller sued. The trial court excused the purchaser on two grounds. First, the collapse of the demand for natural gas constituted a "failure of gas . . . markets" under a contractual force majeure clause. Second, Oklahoma law made it illegal for the seller to produce and thus tender more gas than the purchaser could take. On appeal the Oklahoma Supreme Court reversed. It held the force majeure clause inapplicable to the decline in demand for natural gas because other provisions of the contract implied that the purchaser had assumed this risk of declining demand.[174] The court further held

169. These agreements resulted, in part, because the relative scarcity of natural gas in the early 1970s gave gas producers the bargaining power to negotiate such contracts with their customers, natural gas pipelines. *See* Medina, McKenzie & Daniel, *Take or Litigate: Enforcing the Plain Meaning of the Take-or-Pay Clause in Natural Gas Contracts,* 40 Ark. L. Rev. 185, 191–92 (1987), and authorities cited there.

170. The demand for natural gas sagged for several reasons: increasing market price caused by deregulation of most natural gas prices in 1978; declining oil prices which made oil an attractive energy alternative to natural gas; energy conservation efforts; a severe economic recession; and abnormally warm weather during the 1982–83 heating season. *See* Turner, *Natural Gas—Impact of Deregulation or Reregulation on Sales Contracts,* 29 Rocky Mtn. Min. L. Inst. 501, 510–13 (1983); Comment, *Take-or-Pay Provisions: Major Problems for the Natural Gas Industry,* 18 St. Mary's L.J. 251, 257–59 (1986).

171. Generally, purchasers have not been able to use U.C.C. § 2-615 to avoid liability under take-or-pay contracts if the seller decides to litigate. See Medina, McKenzie & Daniel, *supra* note 169, at 233 n.152 for citations to relevant cases.

172. 756 P.2d 1209, 5 U.C.C. Rep. Serv. 2d (Callaghan) 605 (Okla. 1988).

173. Turner, *supra* note 170, at 511.

174. In finding that the force majeure clause did not apply the court reviewed the contract and found the parties' general purpose to be to "[assure] themselves of the ability to purchase and sell for a term of years at a bargained-for price." 756 P.2d at 1213, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 610. It then held that to interpret the force majeure clause to excuse the purchaser would frustrate that general purpose. The court buttressed this conclusion by reciting the extensive contract

that Oklahoma law did not make illegal the tender of more gas than the purchaser could sell. In a concurring opinion, two judges held that the purchaser was not excused under U.C.C. section 2-615. In their view the purchaser had failed to prove both that the gas crisis was unforeseeable and that the cost to the purchaser was so extreme and unreasonable as to make its performance impracticable.

The second case, *Resources Investment Corp. v. Enron Corp.*,[175] was decided by the United States District Court for the District of Colorado. Here producers of natural gas brought suit on thirty-two take-or-pay contracts executed over a period of eighteen years. The purchasers defended on various grounds including impossibility/commercial impracticability and excuse under contractual force majeure clauses. The producers moved to strike several of these defenses including those of frustration of purpose, impracticability, and force majeure.[176] As a basis for the impracticability defense, the purchasers alleged the occurrence of a variety of events that had precipitated the natural gas crisis in the early 1980s.[177] The court held that the only possible excusing events were the abnormally warm weather and the enactment of federal and state regulatory legislation. Thus it permitted the defenses of frustration and impracticability to survive. The court dismissed the force majeure defense because of the purchasers' failure to comply with notice requirements contained in the force majeure clause.

In these three cases, and in most impracticability cases, the concept of implicit risk assumption lurks on the threshold. Indeed in many cases it can be the determining factor. Thus in the *Florida Power & Light* case the district court refused to excuse Westinghouse in large measure because it believed that Westinghouse had assumed the risk that reprocessing facilities would not become available. Similarly in *Golsen*, the Oklahoma Supreme Court found that the contract in suit implicitly allocated to the purchaser the risk of the decline in demand for natural gas. In some instances courts infer the allocation of risk from other provisions in the contract, and sometimes they infer the allocation of risk from the fact that the events in question were foreseeable when the parties contracted. Such inferences can be proper when they are strong and compelling but in many cases the inferences are debatable and controversial.[178] In any event,

provisions for price redetermination upon the occurrence of certain events. The court stated that to excuse the purchaser under the force majeure clause would frustrate these specific provisions as well. *Id.* at 1214, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 610–11.

175. 669 F. Supp. 1038, 5 U.C.C. Rep. Serv. 2d (Callaghan) 616 (D. Colo. 1987).

176. The other defenses included attacks on the legality of the "take-or-pay" clauses as: (i) against public policy; (ii) a violation of state conservation and proration laws; and (iii) penalty or unenforceable liquidated damages clauses. The purchasers also attacked the "take-or-pay" clauses as unconscionable and as the result of mutually mistaken assumptions. They also alleged frustration of purpose. The court dismissed all these defenses. 669 F. Supp. at 1039–43.

177. *Id.* at 1043. For a listing of these events see *supra* note 170.

178. *Cf.* Golsen v. ONG Western, Inc., 756 P.2d at 1221–22, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 613–14 (Kauger, J., concurring) (referring to effect of loose interpretation of foreseeability standard on defense of impracticability).

these inferences play a far more significant role in deciding cases under U.C.C. section 2-615 than the Code drafters seem to have intended.

Perhaps the time has come to return to the drafter's intent. The decision to excuse for commercial impracticability under U.C.C. section 2-615 should be essentially a two-step process. First one must decide whether the event for which excuse is sought was *foreseen* at the time the parties made their contract. If not, and if certain other conditions are satisfied,[179] then the nonoccurrence of that event was a basic assumption on which the contract was made. All this means is that the contract fails to provide for the occurrence of that event. There is, thus, a gap in the contract which needs filling. That gap is filled by the second step: Has the event rendered performance impracticable? If so, the promisor is excused; if not, he must perform or pay damages. The test of impracticability is onerous. If the unforeseen event does not render performance physically impossible but only increases the cost of performance, then the promisor, to be excused, must show that the increased cost is extreme and unreasonable.[180] Under this standard, a court should be permitted to consider the effect of excuse or nonexcuse upon the respective parties, as did the Fourth Circuit in the *Florida Power & Light* case. Since, in many of the litigated cases, events causing extreme cost increases will not have been foreseen, the practical effect of this two-step approach will be to focus analysis upon the effect of excuse or nonexcuse upon the respective parties. This approach is fairer than one that wrestles with the ill-defined concept of implicit risk assumption.

The approach recommended here is not incompatible with the parties' freedom to contract. If the parties explicitly—or by trade usage, course of dealing, or course of performance—allocate the risk of an event or the risks of unforeseen events generally, that allocation should be honored. But just because the parties have in fact allocated some risks by their contract, this does not mean that they have allocated all the risks. When parties agree, for example, to a fixed price contract, they allocate reasonable risks of price fluctuation, but not unreasonable risks. Similarly, when the parties demonstrate awareness of future risks—for example, by drafting flexible pricing or flexible quantity terms—again they allocate a reasonable range of fluctuations beyond the limits so provided. Yet, should an unusual and unforeseen fluctuation occur that would cause extreme and unreasonable cost to one party, then absent strong evidence otherwise, the contract should not be read to have implicitly allocated that risk. Thus, for example, in the *Golsen* case, the court could have construed the flexible provisions to cover reasonable fluctuations in the demand for gas and the "failure of gas markets" provision in the force majeure clause to cover unreasonable fluctuations; unfortunately it chose to view them as inconsistent. The time has come to recognize that contracts typically allocate only some

179. *See supra* text accompanying note 152.

180. For cases see Wladis, *supra* note 151, at 584 n.323. This appears to be consistent with the drafter's intent. *Id.*

risks.[181] When risks not allocated occur, the soundest basis for deciding whether to excuse or not is the relative effect of that decision upon the respective parties. The opinion of the Fourth Circuit in the *Florida Power & Light* case moves the law in this direction and for that reason is to be applauded.

Reclamation

It is well settled that a seller may reclaim under Bankruptcy Code section 546(c) and U.C.C. section 2-702 only those goods which are identifiable and in the buyer's possession when it receives the reclamation demand.[182] *In re Wheeling-Pittsburgh Steel Corp.*[183] illustrates some of the interpretive problems that lurk within such an apparently simple rule. Just prior to the buyer's bankruptcy, the seller sold and delivered low volatile coal. On the date written demand was made for reclamation, some of the coal had been manufactured into coke and some was sitting atop low volatile coal of like grade supplied by other sellers.

First, the bankruptcy judge held that U.C.C. section 2-702 does not extend the right of reclamation to products of goods. He noted that the section's first reference to "goods" means the goods purchased and that the subsequent reference to "the goods" obviously refers to the "goods" first mentioned.[184] The judge further buttressed his opinion by pointing to the absence of any mention of products in the Code's definition of "goods"[185] and to U.C.C. section 9-315 as evidence that the drafters knew how to use the term "products" when they wanted to.[186] Accordingly, the seller had no right to reclaim the coke.[187]

If a seller can trace its goods into a product, what policy reason is there for denying reclamation? The most compelling is that the product consists of value added by the buyer which, if given to the seller, would be paid for by buyer's other creditors. But why not recognize a claim limited by the value of the original goods, rather than the value of the product? In fact, the court essen-

181. *See generally* Farnsworth, *Disputes Over Omission in Contracts,* 68 Colum. L. Rev. 860 (1968). Some courts have grasped this point. *See* Wladis, *supra* note 151, at 568 n.244.

182. *See, e.g., In re* Rawson Food Serv., 846 F.2d 1343, 6 U.C.C. Rep. Serv. 2d (Callaghan) 128 (11th Cir. 1988) (proof of possession is a necessary part of seller's prima facie case).

183. 74 Bankr. 656, 4 U.C.C. Rep. Serv. 2d (Callaghan) 79 (Bankr. W.D. Pa. 1987).

184. U.C.C. § 2-702(2) begins as follows: "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 receipt . . . . " (Emphasis added.)

185. *See* U.C.C. § 2-105(1).

186. *See* U.C.C. § 9-315(1) ("If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass . . . ."). *See also* Frisch, *U.C.C. Section 9-315: A Historical and Modern Perspective,* 70 Minn. L. Rev. 1 (1985).

187. The seller also argued, without regard to U.C.C. § 2-702, that the common law of accession gave it the right to reclaim. The court correctly rejected this assertion on the ground that the buyer owned the materials, including the coal sold by the seller, *see* U.C.C. § 2-401, that went to make up the whole.

tially took this approach when it recognized the seller's claim to the unprocessed coal.[188]

Returning again to the definition of goods which we are told includes "an undivided share in an identified bulk of fungible goods,"[189] Judge Bentz was able to reach a different result with regard to the unprocessed coal.[190] After determining that fungible goods could be reclaimed, he held that the identification requirement was satisfied where, as here, the goods can be traced into an identifiable mass shown to consist of goods of like kind and grade. However, concerned that actual reclamation of coal of the kind and grade sold by the seller would inaccurately measure the seller's entitlement on the date of its demand, the court granted an administrative claim in the amount of the purchase price plus interest at the legal rate.[191] It is curious that despite the court's concern that the seller not be over or undercompensated, the court selected an interest rate which has no relation to the seller's lost opportunity cost.[192]

Courts continue to grapple with the appropriate relationship between Bankruptcy Code section 546(c) and U.C.C. section 2-702. Although nothing within the former section indicates that it was intended as anything but a safe-harbor from the trustee's avoidance powers, most courts have held that compliance with its provisions is essential.[193] Occasionally, however, a dissenting voice is heard. In *In re Bearhouse*,[194] the bankruptcy court considered the effect of a timely oral demand on a seller's right to reclaim. The court distinguished the case before it from the bulk of those which have construed the written demand requirement of section 546(c) as mandatory. Those cases involved a bankruptcy filing within ten days after the delivery of the goods, whereas here, the filing occurred after the ten-day demand period had expired. Thus, on the petition date, compliance with section 546(c) was no longer possible. The court reasoned that to make insufficient that which was sufficient when done would be "inconsistent with fundamental principles of due process of law."[195] But, having the right to reclaim in the abstract is one thing; having it hold up against the trustee's asserted avoidance powers is quite another. Looking to pre-Code Arkansas case law, the court held that since the right would be superior to the lien of a

188. At the time of the court's decision, the unprocessed coal, too, had been processed into coke.

189. 74 Bankr. at 660, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 84.

190. Actually there is no reference to fungible goods in the definition. What Judge Bentz calls part of the definition is apparently the statement in U.C.C. § 2-105(4) that "[a]n undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined."

191. The court felt that the seller would be over or undercompensated depending on whether the current price for similar coal was higher or lower than it was on the date its return was demanded.

192. Also worthy of note is the decision to award interest from the date of demand. This fails to account for the inevitable delay that the seller would have experienced in its attempt to dispose of the coal.

193. *See, e.g., In re* Rozel Indus., 74 Bankr. 643, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1448 (Bankr. N.D. Ill. 1987) and cases cited therein.

194. 84 Bankr. 552, 6 U.C.C. Rep. Serv. 2d (Callaghan) 1124 (Bankr. W.D. Ark. 1988).

195. 84 Bankr. at 560, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 1133.

judgment creditor it withstands avoidance under Bankruptcy Code section 544(a)(1).

The result is unobjectionable but the opinion seems strained and incomplete. The timing of the bankruptcy petition is, in this context, hardly a sufficient ground on which to differentiate the rights of sellers. One suspects that Judge Mixon sought an excuse to deviate from the weight of authority and found one. However, missing from the opinion is a consideration of several other potentially applicable avoidance powers.[196]

Buyer's Money Remedies and Their Limitations

Crucial to a buyer's right to recover "cover" damages is a "reasonable purchase of or contract to purchase goods in substitution for those due from the seller."[197] Whether the cover goods were reasonable substitutes for the contract goods was considered by the Iowa Supreme Court in *Kanzmeier v. McCoppin.*[198] The seller entered into a contract to sell 360 head of feeder cattle for $60 per hundred weight. The seller almost immediately noticed that similar cattle were selling for slightly more, so he informed buyer's agent that he was not quite ready to sell. A day later he sold to a third party for $62 per hundred weight. Not surprisingly, the buyer sued. The trial court awarded damages under U.C.C. section 2-712 based on the difference between $60 per hundred weight (contract price) and the hundred weight price of 358 head of replacement cattle.

The supreme court reversed. The court found a fundamental problem with the cover: The replacement cattle weighed on the average 135 pounds less than the seller's cattle. The court stressed that cover means commercially usable as a reasonable substitute. The goods need not be identical to those under the original contract but they must be a substitute of like kind. Whether an item is cover is a question of fact. However, after reviewing the record the court found no substantial evidence that the 358 replacement cattle were a reasonable substitute. Consequently, the damage award was overturned. The case was remanded for retrial of damages under U.C.C. section 2-713[199] and for consideration of the buyer's lost profits claim.

What seems remarkable is the court's method of comparing the replacement cattle with the seller's cattle. First, the seller had "big steers" that could be fed out for an April market. Since the replacement cattle were lighter and were purchased later, they could not be ready for market until almost two months after the seller's cattle. Second, since the seller's cattle were *local* and out of *one group,* inferentially they would be more prone to sickness.

196. Absent the protection of 11 U.S.C. § 546(c) (1982), the right of reclamation could be challenged as a statutory lien under § 545(1)(D) or a preferential transfer under § 547.

197. U.C.C. § 2-712(1).

198. 398 N.W.2d 826, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1084 (Iowa 1987).

199. The basic measure of damages under this section is the difference between the contract price and the market price at the time the buyer learned of the breach.

Finally, there was no evidence that the price of lighter cattle was similar to the price of heavier cattle at the time of purchase. Since the buyer may have paid more per pound for lighter animals, there was, in the court's view, no way to tell whether the higher cover price resulted from a market increase. This analysis may leave a farmer puzzled. Must the non-breaching party find a herd the same size as the breaching party's herd, in the same locale, with cattle at the same weight within a reasonable time? When asked if he *could find anything comparable,* the non-breaching farmer answered: "No."

The buyer's entitlement to cover damages was also involved in *State of New Mexico ex rel. Concrete Sales & Equipment Rental Co. v. Kent Nowlin Construction Co.*[200] There the buyer, a general contractor, was awarded a state contract for highway construction. It then subcontracted with the seller for the purchase of crushed aggregate materials. When the seller failed to timely supply an adequate amount of intermediate aggregate, the buyer purchased the material from another subcontractor. The New Mexico Supreme Court concluded that the buyer's subsequent acceptance of a partial delivery by the seller did not preclude recovery on the basis of the previous cover. There is no need, the court said, either to cancel an installment contract or to notify the breaching seller before exercising the remedy of cover. Moreover, in a confused reference to U.C.C. section 2-612(3), the court observed that a partial delivery is not a nonconforming installment.[201]

The issue whether a particular loss is an appropriate item of consequential damages has always been one of the more frequently litigated remedial issues. This year was no exception. In *Fortin v. Ox-Bow Marina, Inc.,*[202] a Massachusetts court for the first time was called upon to decide whether interest on money borrowed to refinance a loan on a trade-in in order to make a new purchase (a boat) is recoverable when the buyers have properly revoked their acceptance. The court held that it was[203] but failed to adequately explain why winterizing and storage charges as well as the initial loan application and approval fees were not. In *Navistar International Corp. v. Hagie Manufacturing Co.,*[204] a buyer sought to recover lost profits from the anticipated resale of goods that it would have contracted to purchase from the seller if no problems in their existing contractual relationship had arisen. Rejecting this claim, the district court wisely concluded that a seller is not responsible for losses associated with goods that it is under no obligation to sell.

200. 106 N.M. 539, 746 P.2d 645, 5 U.C.C. Rep. Serv. 2d (Callaghan) 598 (1987).

201. Under U.C.C. § 2-612(3), acceptance of a nonconforming installment without notice of cancellation reinstates the contract if there had been a prior breach of the whole contract. But this is a reference to the future, not the past. There is nothing in this provision which would suggest that reinstatement excuses a breach or precludes a cover measure of damages for that breach.

202. 4 U.C.C. Rep. Serv. 2d (Callaghan) 1046 (Mass. Super. Ct. 1987).

203. On the theory that an award of lump sum damages permits a replacement purchase without the need for further borrowing, other courts have held that the interest on money borrowed to make a purchase is not recoverable. *See, e.g.,* Barnard v. Compugraphic Corp., 35 Wash. App. 414, 667 P.2d 117, 37 U.C.C. Rep. Serv. (Callaghan) 141 (Wash. Ct. App. 1983).

204. 662 F. Supp. 1207, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1096 (N.D. Ill. 1987).

In *In re Meyertech Corp.*,[205] the application of one measure of damages yielded the sum of $11,912.50, whereas the application of another measure would have yielded the sum of $404,404.55. Not surprisingly, the parties disagreed on which measure was appropriate. The buyer had incorporated the seller's fittings into sprinkler systems which it had installed in a number of construction projects. When the fittings turned out to be defective, the buyer was forced to replace them and to repair damage caused by water leaks. The bankruptcy court rejected the buyer's claim for damages based upon the total cost theory.[206] Instead, it awarded as damages the cost of replacing the faulty fittings. Its rationale was that there was insufficient evidence to support the buyer's bid estimates on the construction jobs. On appeal, the Third Circuit agreed that the total cost method was inappropriate but for a different reason, i.e., the cost of replacement established the loss with a reasonable degree of accuracy. Curiously, there is no mention of any allowance for the cost incurred in repairing the water damage. This may account for the enormous disparity in the results between the two measures.

A number of cases involving attempts by sellers to limit the buyer's remedies were litigated this year. Several are worthy of comment.

In *Lindemann v. Eli Lilly & Co.*,[207] the plaintiff purchased a herbicide manufactured by the defendant to control weeds in growing cotton. The jury found a breach of the express warranty that the product would control weeds and grasses and that the breach of warranty was the proximate cause of the plaintiff's losses of $150,000 in crop damage and $6,000 in direct economic loss in the value of the herbicide. The trial court ruled sua sponte that the clause in the contract precluding recovery of consequential damages was unconscionable.

On appeal, the Fifth Circuit Court of Appeals ruled that the trial court's practice of raising the issue sua sponte during the charge conference immediately before submitting the case to the jury was prejudicial to the defendant because a court must have evidence to establish unconscionability and because a party whose term or contract is challenged as being unconscionable must be given fair notice in order to provide evidence to the contrary. The latter ruling is clearly required by the second subsection of U.C.C. section 2-302, whereas the former, that there must be evidence of unconscionability before such a determination can be made, does not appear to accord with either the express language of section 2-302 or the practice of many courts, particularly in consumer transactions. The appellate court found the limitation of liability to be a mere allocation of risk permitted by the Code, absent oppression and unfair surprise.

205. 831 F.2d 410, 5 U.C.C. Rep. Serv. 2d (Callaghan) 354 (3d Cir. 1987).

206. Damages under the total cost theory would equal the buyer's costs incurred for overruns on the construction projects where the repairs were necessitated. To be applicable, the following requirements must be met: (i) The nature of the particular losses make it impossible or highly impracticable to determine them with a reasonable degree of accuracy; (ii) the plaintiff's bid or estimate was realistic; (iii) its actual costs were reasonable; and (iv) it was not responsible for the added expenses. 831 F.2d at 419, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 358 (citing John F. Harkins Co. v. School Dist., 313 Pa. Super. 425, 460 A.2d 260 (Pa. Super. Ct. 1983)).

207. 816 F.2d 199, 4 U.C.C. Rep. Serv. 2d (Callaghan) 395 (5th Cir. 1987).

Although the court discussed the many factors which might cause the failure of a crop treated with an herbicide as a reason for including the remedy limitation, such clauses appear to be included in such contracts mainly because the farmer is in a better position to know the extent of and protect against consequential damages. The farmer may protect against consequential damages by diversifying the kinds of herbicides he uses and/or by obtaining crop insurance to the extent it is commercially available.

In *Nunes Turfgrass, Inc. v. Vaughan-Jacklin Seed Co.,*[208] the court upheld a limitation of remedies to return of the purchase price for grass seed that was sold in violation of an express warranty that it conformed to federal label descriptions and an implied warranty of fitness for a particular purpose. The seller and the buyer, who had done business together for approximately twenty years, entered into a contract for the sale and purchase of a perennial ryegrass for overseeding fields of bluegrass. The defendant delivered seed contaminated with an annual rye grass which, when planted by the plaintiff, rendered his fields unsuitable for sale as sod. The plaintiff subsequently followed corrective measures recommended by the defendant but was unable to market his seed at the normal time and was forced to sell his fields for sod.

The California Court of Appeals upheld the trial court's ruling that the limitation of remedies was not unconscionable since the parties had dealt together for approximately twenty years and that the plaintiff read and understood the limitation of remedies. Moreover, the court cited the fact that the plaintiff was a large commercial seller with eight sales outlets in California and that the plaintiff placed similar remedy restrictions on its sales of seed.

These cases are inconsistent with a number of recent cases holding such limitations of liability or exclusions of warranty to be ineffective in commercial cases of a similar character, although those cases may be distinguished by the purported sophistication or lack thereof of the buyers.[209] Indeed, absent evidence of fraud, duress, or undue influence, there would appear to be no legitimate purpose in setting aside clauses limiting liability for consequential damages.

Finally, consider *Comind, Companhia De Seguros v. Sikorsky Aircraft Division of United Technologies Corp.*[210] In September 1975 Votec Servicos Aeros Regional, S.A. ("VOTEC") contracted to purchase a helicopter from the defendant ("UTC"). VOTEC received delivery in September 1979, paying the purchase price of $1.6 million. On March 20, 1980, the helicopter crashed, killing fourteen people and destroying the craft. Comind, VOTEC's insurer, paid the latter for the costs of the accident and brought the present action to recover from the defendants. Evidence available to the court suggested that the accident occurred due to failure of a bearing race within the rotary mechanism which held the blades in place. The defendants sought summary judgment based

208. 200 Cal. App. 3d 1518, 246 Cal. Rptr. 823, 6 U.C.C. Rep. Serv. 2d (Callaghan) 41 (Cal. Ct. App. 1988).

209. *See, e.g.,* Martin v. Joseph Harris Co., 767 F.2d 296, 44 U.C.C. Rep. Serv. (Callaghan) 588 (6th Cir. 1985); Durham v. Ciba-Geigy Corp., 315 N.W.2d 696 (S.D. 1982).

210. 116 F.R.D. 397, 5 U.C.C. Rep. Serv. 2d (Callaghan) 575 (D. Conn. 1987).

on three clauses in the sales contract. First, they relied on a warranty and remedy limitation which excluded implied warranties of merchantability and fitness for a particular purpose. A second provision expressly warranted the craft against defects in material and manufacture but limited the buyer's remedy to repair or replacement of any defective part provided that written notice of such defect was given to the defendants within ninety days after the first operation of the craft and, in any event, no later than one year after delivery of the craft. The contract also provided that seller would not be responsible for any damages in contract or tort in excess of $100,000 and in no event for consequential or incidental damages. Finally, the contract provided that it was to be interpreted "in accordance with the plain English meaning of its terms."

In denying the defendants' motion for summary judgment, the court ruled that if the defect were a latent one not reasonably discoverable within the ninety-day period, the limited remedy may have failed of its essential purpose and operated in a manner to deprive the plaintiff of the substantial benefit of the bargain. The court also indicated that this clause might conflict with the unlimited express warranty in the previous sentence, in which case the language of warranty would prevail over the remedy limitation.[211]

The deficiency in the court's analysis, even on a motion for summary judgment, was its failure to attempt to ascertain what the purpose of the limited remedy was. Perhaps it was to shift the risk, even as to latent defects not discovered within ninety days of operation, to the buyer as a means of minimizing what might have been inherent problems in determining whether the craft failed in operation due to a defective part or improper maintenance or to induce the plaintiff to inspect the helicopter early in its operation for latent defects which might have been more costly to discover in the manufacturing process. It may have been that the parties failed to address themselves to the problem of latent defects, but the contract provision mandating that the terms be interpreted in accordance with their plain English meaning could be argued to preclude further inquiry as to whether the ninety-day notice term applied to latent defects.

The court also called into question the clause in the contract which limited monetary damages to no more than $100,000 and precluded the plaintiff from recovering consequential damages.[212] The court opined that the dollar amount limitation might be an unreasonable forecast of anticipated loss[213] or unconscio-

211. On this point, the court cited Wilson Trading Corp. v. David Ferguson Ltd., 23 N.Y.2d 398, 297 N.Y.S.2d 108, 244 N.E.2d 285 (1968).

212. Although the court treated the dollar amount limitation clause as a liquidated damages clause, it did not operate as such in the classical sense since the buyer still had to prove actual damages from breach, a requirement which does not exist under a liquidated damages clause. *See* 5 Corbin, Contracts § 1062 (1964). After proving actual direct economic loss, the buyer was then restricted in the amount of his recovery up to $100,000. In the language of U.C.C. § 2-718(1), the damages were not liquidated "at an amount" since actual loss had to be proved.

213. *See* U.C.C. § 2-718(1).

nable given the loss of a $1.6 million aircraft.[214] Moreover, the court indicated that the clause excluding consequential damages might be unconscionable under U.C.C. sections 2-719(3) and 2-302. Given the criteria which courts ordinarily use to determine unconscionability, it is difficult to perceive how this clause could be considered unconscionable. The buyer clearly had better information about the amount of any consequential loss and could (did, in fact) insure against such a loss. On the facts given, the limitation of liability for consequential damages would appear to be an appropriate allocation of the risk of insuring against such loss.

Seller's Money Remedies

The ability of sellers to recover lost profits under U.C.C. section 2-708(2) has been one of the Code's most enduring remedial puzzles.[215] Not surprisingly, it continues to be the subject of frequent litigation.

In *R.E. Davis Chemical Corp. v. Diasonics, Inc.*,[216] the plaintiff contracted to purchase a piece of medical diagnostic equipment manufactured by the defendant. The plaintiff made a $300,000 deposit but subsequently breached by refusing to take delivery and pay the balance. The defendant resold the equipment to a third party for the same price as the contract price. When the plaintiff sued for restitution of the deposit plus interest under U.C.C. section 2-718(2), the defendant claimed an offset under sections 2-718(3) and 2-708(2) as a lost volume seller. The district court entered summary judgment for the plaintiff. The court held that a lost volume seller is not entitled to recover damages under section 2-708(2) but rather is limited to recovering the difference between the resale price and the contract price along with incidental damages under U.C.C. section 2-706(1).

On appeal the Seventh Circuit, following well established case law from jurisdictions other than Illinois, stated that section 2-708(2) can be applied in situations where a commercially reasonable resale has occurred.[217] Of necessity, this conclusion was based on a projection of what the Illinois Supreme Court would do if the question were presented. However, the Seventh Circuit went further and sought to provide guidance on remand. The court addressed the matter of the proof required for the seller to establish its lost profit under section 2-708(2). The value of the case lies in this discussion.

214. The ceiling may have been a reasonable one for the kinds of direct economic losses anticipated to be suffered by breach of the express warranty.

215. The literature on this section is extensive. *See, e.g.*, Childres & Burgess, *Seller's Remedies: The Primacy of U.C.C. 2-708(2)*, 48 N.Y.U. L. Rev. 833 (1973); Harris, *A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared*, 18 Stan. L. Rev. 66 (1965); Shanker, *The Case for a Literal Reading of U.C.C. Section 2-708(2) (One Profit for the Reseller)*, 24 Case W. Res. L. Rev. 697 (1973).

216. 826 F.2d 678, 4 U.C.C. Rep. Serv. 2d (Callaghan) 369 (7th Cir. 1987).

217. A similar conclusion was reached in two other cases decided this year. *See* Van Ness Motors, Inc. v. Vikram, 221 N.J. Super. 543, 535 A.2d 510, 6 U.C.C. Rep. Serv. 2d (Callaghan) 138 (N.J. Super. Ct. App. Div. 1987); Malone v. Carl Kisabeth Co., 726 S.W.2d 188, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1075 (Tex. Ct. App. 1987).

First, says the court, the seller must prove that it is a lost volume seller. The court starts with the following formula gleaned from precedents: "[A] lost volume seller . . . [is] one that has a predictable and finite number of customers and that has the capacity either to sell to all new buyers or to make the one additional sale represented by the resale after the breach."[218]

Since a sale has been lost by the breach, the emphasis has been on capacity in the precedents cited. The Seventh Circuit states, however, that this emphasis imperfectly reflects economic reality because a volume seller (capable of producing the item to match the breached contract) may be a seller approaching a point of diminishing returns; i.e., it may not be worthwhile for a seller to produce one more item. Consequently, to establish its case on remand, seller must establish not only that it had the capacity to produce the "breached unit" in addition to the unit sold, but also that it would have been profitable to do so.

Thus, the lost volume seller has a double burden to prove its offset under section 2-718(3). What proof will suffice? The case offers no guidance. It seems that section 2-708(2) could become more complicated than necessary for the disposition of run-of-the-mill cases because the court is suggesting nothing less than an economic analysis of the seller's business. Obviously, proof of any lost profit requires some economic analysis to demonstrate that the seller was doing more than breaking even. That, however, appears to be less than what the court intended. A lost volume seller must be creative in getting its proof for trial in order.

U.C.C. section 2-704 is designed to give guidance to a seller who has on hand unfinished goods at the time of the buyer's repudiation. In particular, subsection (2) provides that the "seller may in the exercise of reasonable commercial judgment . . . either complete the manufacture . . . or cease manufacture and resell for scrap or salvage value . . . ." Does this mean that the seller is obliged to complete manufacture if it would be commercially unreasonable not to? In *Madsen v. Murrey & Sons Co.*,[219] the Utah Supreme Court gives an affirmative answer without so much as a passing reference to section 2-704. That case involved a contract for the sale of 100 not so ordinary pool tables for a total purchase price of $55,000. They were to have customized rails designed by the buyer to simulate the lighting and sound effects of a pinball machine. Unable to develop a satisfactory design, the buyer repudiated after having paid $42,500. The seller's response was to dismantle the tables, use the salvageable material to manufacture other tables, and send the rest up in smoke as firewood. In the buyer's suit for restitution,[220] the trial court determined that the seller's actions were commercially unreasonable and awarded it as an offset the difference between what the buyer paid ($42,500) and what the tables would have sold for had the seller completed their manufacture ($21,250).

218. 826 F.2d at 683, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 375–76 (citations omitted).

219. 743 P.2d 1212, 5 U.C.C. Rep. Serv. 2d (Callaghan) 99 (Utah 1987).

220. As in the *Diasonics* case, *supra* notes 216–18 and accompanying text, the buyer's claim for the return of all monies paid on the contract arose under U.C.C. §§ 2-718(2), (3).

On appeal, the Utah Supreme Court concluded that there was sufficient evidence to support the trial court's finding that the doctrine of mitigation of damages mandated completion of the tables. With that said, the court proceeded as if mitigation had occurred. It held that damages should be determined under U.C.C. section 2-708(1), thus entitling the seller to an offset equal to the difference between the market price of completed tables ($21,250) and the contract price ($55,000).[221]

The court's opinion is disappointing in one important respect. With so much potentially at stake, one would have expected more than a summary affirmance of the trial court's decision on the issue of commercial reasonableness. For the future, sellers and courts need some idea of what factors should be taken into account and the relevant weight of each.[222]

Interestingly, in another case, on remand, a district court ruled that a general duty of mitigation unduly restricts the statutory standard of commercial reasonableness. In *Masters Machine Co. v. Brookfield Athletic Shoe Co.,*[223] the seller sought recovery of interest expense as an item of incidental damages.[224] One issue for the trial court was whether its failure to instruct the jury on the general duty to mitigate warranted a new trial. The court believed that not only was such an instruction "unnecessary and confusing, it misstates the law."[225] Commercially reasonable expenses are recoverable even if "alternative reasonable steps were available to [the seller] to minimize such expenses."[226] If the court meant by this that commercial reasonableness is a standard which may

221. If the court had approved of the seller's decision to cease production of the tables, the applicable measure of its offset (damages) would have been the lost profits formula of U.C.C. § 2-708(2).

222. In justification of its actions, the seller offered the following explanation:

> [S]elling the tables as "seconds" would damage its reputation for quality and . . . the various holes, notches, and routings placed in the tables to accommodate the electrical components to be installed by buyer weakened the structure of the tables so as to submit seller to potential liability if they were sold on the market.

743 P.2d at 1215, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 102.

223. 663 F. Supp. 439, 4 U.C.C. Rep. Serv. 2d (Callaghan) 752 (D. Me. 1987). The prior unreported opinion of the First Circuit can be found at 4 U.C.C. Rep. Serv. 2d (Callaghan) 749 (1st Cir. 1986).

224. The seller claimed interest, paid after the date of breach, on money borrowed because of the buyer's failure to pay the full purchase price. U.C.C. § 2-710 permits an aggrieved seller to recover, as incidental damages, "any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach."

225. 663 F. Supp. at 443, U.C.C. Rep. Serv. 2d (Callaghan) at 756. Relying on Schiavi Mobile Homes v. Gironda, 463 A.2d 722, 36 U.C.C. Rep. Serv. (Callaghan) 1190 (Me. 1983), and the Official Comment to U.C.C. § 2-710, the court was of the opinion that the general duty of mitigation is subsumed by the incidental damages standard of commercial reasonableness. To require a further instruction on mitigation would, it thought, confuse the jury and unduly restrict the recovery of incidentals. The latter concern is legitimate, however, only if the duty to mitigate is not always satisfied by behavior that is commercially reasonable. If so, then the court's conclusion regarding subsumption is wrong.

226. 663 F. Supp. at 442, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 756.

validate several alternative courses of action then it is clearly correct. The fact that other conduct would have minimized the loss should not decide the issue. To say that it does would ignore the seller's intangible interests[227] and require of it a foresight that only hindsight can judge.

A second issue in the case involved the trial court's original decision to preclude evidence of interest expense incurred by the seller.[228] On appeal, the First Circuit had held, as a matter of Maine law, that recovery of post-breach interest is not limited to loans made specifically to finance the subject matter of the contract. Whether the interest expense is incidental damages depends not on the type of loan but rather on whether the expense was "commercially reasonable and foreseeable as a result of the alleged breach."[229]

As long as the Code sanctions the recovery of incidental damages and makes, at best, the seller's recovery of consequential damages unclear, the courts will invariably be called upon to distinguish the two. Not only does the Code make this job inevitable, but often so will the contract. In *Commonwealth Edison Co. v. Allied Chemical Nuclear Products,*[230] the court had before it a mind-boggling claim for some $293 million in storage costs for irradiated fuel refused by the buyer and a contractual provision excluding the recovery of consequentials. While not disputing the buyer's contention that under pre-Code law incidental damages were a subcategory of consequential damages, the court recognized that under the Code there is a difference and the difference matters.[231] It concluded that the storage costs were recoverable as incidental damages.[232] Overlooked by the court was the possibility that the intended meaning of the term "consequential damages" in the contract was broad enough to encompass losses which the Code categorizes as incidental. This case required the construction of the parties' contract and not, as the court assumed, the application of the Code. In the future, parties would do well to make more explicit their intended allocation of risks.

227. Consider, for example, the *Madsen* case, *supra* notes 219–22 and accompanying text. Is not the seller's interest in preserving its reputation as a maker of quality pool tables as worthy of protection as is the buyer's interest in the minimization of liability?

228. The nature of the interest expense may matter because nowhere does the Code explicitly sanction the seller's recovery of consequential damages. Recently, courts have begun to characterize interest expense as a recoverable item of incidental damages where the money was borrowed to enable the seller to perform the contract in question. *See, e.g.,* Bulk Oil (U.S.A.), Inc. v. Sun Oil Trading Co., 697 F.2d 481, 35 U.C.C. Rep. Serv. (Callaghan) 23 (2d Cir. 1983); Intermeat Inc. v. American Poultry Inc., 575 F.2d 1017, 23 U.C.C. Rep. Serv. (Callaghan) 925 (2d Cir. 1978); Stokes v. Roberts, 289 Ark. 319, 711 S.W.2d 757, 2 U.C.C. Rep. Serv. 2d (Callaghan) 520 (1986); Gray v. West, 608 S.W.2d 771, 31 U.C.C. Rep. Serv. (Callaghan) 568 (Tex. Ct. App. 1980).

229. 4 U.C.C. Rep. Serv. 2d (Callaghan) 749, 751 (1st Cir. 1986).

230. 684 F. Supp. 1429, 6 U.C.C. Rep. Serv. 2d (Callaghan) 380 (N.D. Ill. 1988).

231. According to the court, "If incidental damages were nothing more than a subcategory of consequential damages, then § 2-709 and § 2-710 would not exist." *Id.* at 1433, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 386.

232. The storage costs were incidental expenses because they were incurred in the "care and custody of goods after the buyer's breach." *Id.* at 1433, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 385 (citing U.C.C. § 2-710).

Recovery under several Code sections is dependent upon the "identification" of goods to the contract.[233] This year, two cases dealt with fungible goods. In the first, *Great Western Sugar Co. v. Pennant Products*,[234] the seller sued for the price of sugar under U.C.C. section 2-709(1)(b) following the buyer's refusal to accept delivery.[235] A Colorado Court of Appeals held that recovery under this section was permissible even though no sugar had ever been earmarked for the buyer. Relying on a comment,[236] case law,[237] and Code policy,[238] the court determined that a showing that the seller always had on hand enough sugar to satisfy its obligations met the identification requirement.

The second case was *Apex Oil Co. v. Belcher Co.*[239] The contract was for No. 2 heating oil and the Code section under which the seller sought recovery was section 2-706.[240] The case is interesting because there were two relevant post-breach sales. One took place almost immediately after the buyer's breach and was of oil previously set aside for delivery to the buyer. The other took place almost six weeks later and was of oil for the first time identified to the broken contract. The seller argued that it had the right to designate the latter sale as controlling for purposes of section 2-706. The Second Circuit stated that, at least where fungible goods are concerned, an identification once made is not irrevocable. However, any later substitution and resale must be reasonable. That is, it must "accurately [reflect] the market value of the goods which are the subject of the contract."[241] The most pertinent aspect of reasonableness is

233. Identification under U.C.C. § 2-501 usually occurs when a particular good is in some way earmarked for a particular buyer. The event becomes significant through the application of various Code sections. *See, e.g.*, U.C.C. §§ 2-502 (identification, in part, conditions the buyer's right to recover goods from an insolvent seller), 2-716(3) (identification central to the buyer's replevin rights).

234. 748 P.2d 1359, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1080 (Colo. Ct. App. 1987).

235. 4 U.C.C. § 2-709(1)(b) permits the seller to recover the price "of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing." Here the seller was excused from attempts at resale because of a drastic decline in market price and an industry-wide oversupply of sugar.

236. U.C.C. § 2-501 Official Comment 5 ("The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough ... to effect an identification if there is no explicit agreement otherwise.").

237. Martin Marietta Corp. v. New Jersey Nat'l Bank, 612 F.2d 745, 27 U.C.C. Rep. Serv. (Callaghan) 1153 (3d Cir. 1979).

238. The statement of policy appears in U.C.C. § 2-501 Official Comment 2 ("In view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification.").

239. 6 U.C.C. Rep. Serv. 2d (Callaghan) 1025 (2d Cir. 1988).

240. U.C.C. § 2-706(1) establishes damages by computing the difference between the amount received by the seller from the resale of the goods and the contract price. On the facts given, one wonders why the seller did not attempt to establish "lost volume" status and seek recovery under U.C.C. § 2-708(2).

241. 6 U.C.C. Rep. Serv. 2d (Callaghan) at 1037 (citing Servbest Foods, Inc. v. Emesall Indus., 82 Ill. App. 3d 662, 671, 403 N.E.2d 1, 8 (1980)).

timing. Here, because of the volatility of the market for No. 2 oil, the second sale failed to meet the requirements of section 2-706 as a matter of law.

Statutes of Limitations

This year was eventful for buyers and sellers of artwork. *Wilson v. Hammer Holdings, Inc.*[242] should have sellers breathing a sigh of relief and buyers seeking the opinion of an independent expert. In this case, the Wilsons paid more than $11,000 to Hammer Galleries ("Hammer") for what was expressly guaranteed to be an original painting by Edward Vuillard. Twenty-four years later they learned that the painting was not by the French artist. The painting was returned to Hammer and suit was brought to recover damages for breach of warranty and negligence.[243] On Hammer's motion for summary judgment, the district court ruled that the limitations period had run. The court stated that the warranty of authenticity was breached at the time of sale, hence the claim was long-barred by U.C.C. section 2-725. The exception in section 2-725(2) was found to be inapplicable because the warranty made no explicit reference to future performance as required by the statute.

On appeal, the First Circuit Court of Appeals affirmed.[244] The opinion nicely illustrates that, either by design or by oversight, the potential applicability of some Code sections will depend upon the nature of the good involved. Unfortunately for the Wilsons, the nature of a painting is such that the requirements for a future performance warranty under section 2-725(2) are not likely to be met. For one thing, the court expressed doubt whether the concept of "future

242. 850 F.2d 3, 6 U.C.C. Rep. Serv. 2d (Callaghan) 321 (1st Cir. 1988).

243. The court stated that the Wilsons "returned" the painting to the gallery, but the court says nothing about whether the gallery repaid the purchase price. The inclusion of a negligence claim, for which an expectation measure of damages is inappropriate, suggests that it did not. Moreover, expectation damages, if recoverable under U.C.C. § 2-713, would be difficult to prove. Such was the lesson in another case this year, Robert Miller Gallery, Inc. v. Shepard Gallery Assocs., 6 U.C.C. Rep. Serv. 2d (Callaghan) 1076 (N.Y. Sup. Ct. 1988), which also involved the misattribution of artistic responsibility.

244. The court also approved the trial court's dismissal of the negligence claim because "the essence of the action is to recover money under a sales contract for goods that did not conform to the contract. In such instances, the U.C.C. governs the expectations and duties of the buyer and seller." 850 F.2d at 9, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 329.

The appellate court assumes without discussion that the Massachusetts statute of limitations is applicable. The district court notes the problem and, applying the Massachusetts choice-of-law rules, classifies the limitations issue as a procedural one governed by the limitations law of forum. Neither opinion analyzes the transaction's contacts with New York and Massachusetts or the different governmental interests of these states. Recent developments suggest that courts should pay more attention to this conflict of laws issue. In 1982, for example, the National Conference of the Commissioners on Uniform State Laws promulgated the "Uniform Conflict of Laws—Limitation Act," which deems statutes of limitations to be substantive in character. The uniform law applies, in other words, the limitations law of the state whose law governs the substantive claim itself. More recently, the American Law Institute has amended § 142 of the Restatement (Second) of the Conflict of Laws to recognize more fully the interests of other states. While the Massachusetts court would probably apply the Massachusetts limitation rule under the Restatement test, the test does allow for flexibility to consider "exceptional circumstances."

performance" could ever extend to a painting. After all, in what way does a painting perform? Assuming for the sake of argument that the Wilsons were correct in their assertion that it performs by being genuine, the court next asked where was the "*explicit* promise of future performance"?[245] Conceding that there may have been an *implicit* promise, the court felt "that if there is to be an exception to the requirements of the exception, it should be up to . . . lawmakers to design it."[246] Finally, the First Circuit pointed out that, even if all else was resolved in the Wilsons' favor, their claim would nevertheless fail since section 2-725(2) requires that discovery of the breach "*must* await"[247] future performance. Because the authenticity of the painting does not change with time, the Wilsons were no less capable of discovering that the painting was a fake at the time of performance than they were at a later time.

On balance, section 2-725 gave the court little choice but to rule the way it did. It seems that the Wilsons would have been better off had they sought to avoid the application of section 2-725 by seeking to rescind on the basis of mutual mistake of fact. Whether they would have met with success would have depended upon the court's view of the continued availability of rescission under the Code and the provisions of the relevant non-Code statute of limitations.[248]

While on the subject of exceptions to the general limitations period of section 2-725, the latently defective product continues to spawn cases involving allegations of fraudulent concealment and other non-statutory escape valves.[249] In *Kociemba v. G.D. Searle & Co.*,[250] the defendant, a manufacturer of intrauterine devices, printed a patient brochure warning that pelvic infections had been reported, but not that complaints had also been received of pelvic inflammatory disease. When the plaintiff-purchaser was unable to conceive because her fallopian tubes were blocked, she brought suit for breach of express warranties, an implied warranty of fitness for a particular purpose, and the implied warranty of merchantability. When the defendant moved for summary judg-

245. U.C.C. § 2-725(2) (emphasis added).

246. 850 F.2d at 7, 6 U.C.C. Rep. Serv. 2d (Callaghan) at 325. The court called attention to legislation in Michigan and New York addressing the issue directly. *See* Michigan's Works of Fine Arts Statute, Mich. Comp. Laws Ann. § 442.322-324 (Callaghan 1982); N.Y. Gen. Bus. Law § 219-c (West 1988). In the absence of a cross-reference in U.C.C. § 2-725 itself, however, these special laws may not be readily known.

247. U.C.C. § 2-725(2) (emphasis added).

248. The court in Firestone & Parson, Inc. v. Union League, 672 F. Supp. 819, 3 U.C.C. Rep. Serv. 2d (Callaghan) 449 (E.D. Pa. 1987), *aff'd by order,* 833 F.2d 304 (3d Cir. 1987), concluded that, for the purpose of determining the relevant statute of limitations, there was no difference between "revocation of acceptance" and "rescission for mutual mistake of fact." *See also* Frisch & Wladis, *supra* note 144, at 1302.

249. This year's cases include Dade County v. Rohr Indus., 826 F.2d 983, 4 U.C.C. Rep. Serv. 2d (Callaghan) 770 (11th Cir. 1987) (plaintiff's contention that defendants were estopped from asserting the statute was denied); Holstad v. Southwestern Porcelain, Inc., 421 N.W.2d 371, 5 U.C.C. Rep. Serv. 2d (Callaghan) 912 (Minn. Ct. App. 1988) (plaintiff's fraudulent concealment claim was rejected).

250. 680 F. Supp. 1293, 6 U.C.C. Rep. Serv. 2d (Callaghan) 143 (D. Minn. 1988).

ment on the ground that the suit was barred by the statute of limitations, the plaintiff argued that the statute had been tolled under U.C.C. section 2-725(4)[251] because (i) the defendant fraudulently concealed the cause of action, (ii) the defendant is estopped from raising the statute as a defense, and (iii) the defendant expressly warranted the future performance by including a label recommending its use for up to twenty-four months. The district court denied the motion because the plaintiff produced extensive evidence in support of her claim that the defendant had fraudulently concealed information that, if available to the plaintiff, would have led her to bring suit at an earlier time. In dictum, the court suggested that equitable estoppel would be appropriate in this type of case.

The result in the case is unexceptionable. However, there is possible tension in this area between the reference in section 2-725(4) to the unaltered local law on tolling and the general directive in section 1-102(2)(c) "to make uniform the law among the various jurisdictions." Uniform tolling rules would be desirable. It would not seem out of place for a court to consider whether the local tolling rules conform with the rules found in other jurisdictions.

In *Ludwig v. Ford Motor Co.,*[252] a case that arose out of the sale of trucks with allegedly defective engines, the Indiana Court of Appeals was confronted for the first time with the argument that repair promises and efforts will toll the statute of limitations. Recognizing that authority on the issue is divided, the facts of the case made it easy for the court to avoid picking sides. Since repairs were made during the two-year written warranty period and over thirty-six months before plaintiff filed suit, the court thought it obvious that whatever delayed the filing of the suit, it was not the attempted repairs.[253]

As in past years, confusion over the theory of the action often makes uncertain the applicable statute of limitations.[254] In *Persichini v. Brad Ragan, Inc.,*[255] the plaintiff was injured while removing a 7,000-pound tire from a piece of equipment. The cause of the accident, he claimed, was an inaccurate how-to-do-it film supplied to his employer by the defendant, the seller of the tire. The trial court held that the action was a "product liability action" and time-barred by the three-year statute of limitations for such actions. On appeal, the Colorado Supreme Court affirmed. It agreed with the trial court's characterization of the suit as a product liability action and upheld the constitutionality of treating warranty actions under section 2-275 differently.

251. U.C.C. § 2-725(4) states: "This section does not alter the law on tolling of the statute of limitations . . . ."

252. 510 N.E.2d 691, 5 U.C.C. Rep. Serv. 2d (Callaghan) 361 (Ind. Ct. App. 1987).

253. Even if there were circumstances sufficient to toll the statute, the court, relying on Fablok Mills, Inc. v. Cocker Mach. & Foundry Co., 125 N.J. Super. 251, 310 A.2d 491, 13 U.C.C. Rep. Serv. 449 (N.J. Super. Ct. 1973), made the point that the plaintiff must nevertheless be diligent in pursuing its claim after cessation of such circumstances.

254. *See* Frisch & Wladis, *supra* note 144, at 1301.

255. 735 P.2d 168, 4 U.C.C. Rep. Serv. 2d (Callaghan) 96 (Colo. 1987).

As noted in last year's survey,[256] U.S. traders who export or import goods should be aware of the Convention on the Limitation Period of the International Sale of Goods, 1974, as amended by a 1980 Protocol.[257] This convention came into force on August 1, 1988. The following countries are parties to the convention: Argentina, Czechoslovakia, Dominican Republic, Egypt, Ghana, Hungary, Mexico, Norway, Yugoslavia, and Zambia.[258] The United States still has taken no formal steps to accede to the convention but a committee of the Section of International Law and Practice of the American Bar Association is presently studying the convention with a view toward making a recommendation on whether or not the United States should accede.

DOCUMENTS OF TITLE

Under U.C.C. section 7-403(1)(b), "[t]he bailee must deliver goods to a person entitled under the document[259] . . . unless and to the extent that the bailee establishes . . . . (b) damage to or delay, loss or destruction of the goods for which the bailee is not liable, [but the burden of establishing negligence in such cases is on the person entitled under the document]." The bracketed language is optional and has been enacted by a number of states including Maryland.[260]

In *Commodities Reserve Corp. v. Belt's Wharf Warehouses,*[261] the Maryland Court of Appeals in a very thorough opinion considered the effect of the optional language. In that case Commodities Reserve ("bailor"), the owner of a large quantity of Turkish garbanzo beans, stored them in a warehouse owned by Belt's ("warehouseman"). After several months the beans were found to be infested with weevils. The bailor brought suit for negligence against the warehouseman and the owner of a lot of Mexican garbanzo beans stored in the same warehouse and from which the weevils allegedly originated. The case was tried before a U.S. magistrate, who applied Maryland law. Under the facts proved, the weevils either could have been present in the bailor's Turkish beans when they were initially stored or could have infested the Turkish beans from the Mexican beans. The magistrate could not say that one cause was more likely

256. *See* Frisch & Wladis, *supra* note 144, at 1302.

257. *See* U.N. Doc. A/CONF.63/15 (1974), *reprinted in* United Nations Conference on Prescription (Limitation) in the International Sale of Goods—Official Records 101–05, U.N. Doc. A/CONF.63/16, U.N. Sales No. E.74.V.8 (1975) (text of the limitations convention); U.N. Doc. A/CONF.97/18, annex II (1980), *reprinted in* United Nations Conference on Contracts for the International Sale of Goods—Official Records 191–92, U.N. Doc. A/CONF.97/19, U.N. Sales No. E.82.V.5 (1980) (the 1980 Protocol).

258. Current information about the status of the convention may be obtained from the Treaty Section of the Office of Legal Affairs, United Nations, New York, New York 10017; (212) 963-3918.

259. "Person entitled under the document" is defined in U.C.C. § 7-403(4).

260. The bracketed language has been enacted in one form or another by 16 states: Arizona, California, Florida, Idaho, Indiana, Iowa, Kentucky, Maryland, Nevada, New York, North Carolina, Ohio, Oregon, Pennsylvania, Texas, and Wyoming. *See* R. Anderson, *supra* note 66, § 7-403:2.

261. 529 A.2d 822, 4 U.C.C. Rep. Serv. 2d (Callaghan) 560 (Md. 1987).

than the other. Consequently, he found for the warehouseman. He reasoned that under the optional language which Maryland had enacted the bailor had the ultimate burden of persuasion on the negligence issue and that it had failed to carry that burden.[262]

On appeal, the Fourth Circuit certified two questions on burden of proof to the Maryland Court of Appeals.[263] The first question asked in pertinent part, "what is the burden of proof, if any, resting on each (the bailor and the bailee) in establishing the cause of such loss or damage [to stored property]."[264] The Maryland court declared the initial burden to be on the bailor to produce evidence supporting a presumption that the warehouseman was negligent. The bailor might do this in two ways: (i) show a specific lack of care by the warehouseman causing the loss, or (ii) raise a presumption of some unspecified negligence by proving delivery of the goods to the warehouseman in good condition and failure to return the goods at all or in bad condition. The warehouseman might then choose not to put on any case, or more likely as in this case, it could defend. This it might do in two ways: (i) show a specific cause for the loss which was not the result of the warehouseman's negligence, or (ii) if the cause could not be specified but could be reduced to a class of possible causes, show that the warehouseman exercised due care to guard against all of the possible causes. If the warehouseman has introduced legally sufficient evidence of a defense, then the bailor may attempt to rebut that evidence.

On the facts before it, the Maryland court opined that the bailor had produced evidence of negligence, and the warehouseman, evidence of due care. The issue was thus submitted to the fact finder to rule which case prevailed. This brought the court to the second certified question:[265] "As between the bailor and the bailee, who carries the ultimate burden of proof when the evidence . . . is in equipoise?"[266] The court held that the optional language enacted by Maryland placed the burden of persuasion upon the bailor where it alleged negligence. It based this conclusion upon case law, treatises, and the subsection's language. One of the commentators cited, Robert Braucher, was in a position to know what the optional language was intended to do, because he was chairman of the Editorial Board's Subcommittee on Article 7 when the

262. The magistrate's opinion was oral. His reasoning is described in the opinion of the Fourth Circuit on appeal. Commodities Reserve Corp. v. M/S Roumania, 806 F.2d 501, 503–04 (4th Cir. 1986).

263. 529 A.2d at 822–23, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 561 (citing 806 F.2d 501).

264. *Id.*, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 561.

265. The certified questions concerned burden of proof under § 7-403(1)(b) only. Presumably the bailor also had the initial burden of producing evidence tending to prove that it was a "person entitled under the [warehouse receipt covering the goods]," U.C.C. § 7-403(1), so that the warehouseman had a duty to deliver the stored goods to it. Since this element of the bailor's case was not disputed, it was not discussed in any of the courts' opinions.

266. 529 A.2d at 823, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 562.

optional language was added, and he actively participated in the process that led to the addition.[267]

Thus, in states adopting the optional language in U.C.C. section 7-403(1)(b), the bailor who alleges negligent loss or damage to stored goods has the burden of persuading the trier of fact that the bailee's negligence caused the loss or damage. In states not adopting the optional language and in states adopting the optional language where the bailor pleads a tort claim other than negligence, the bailee would seem to have the burden of persuasion on the tort claim.

BULK TRANSFERS

After many years, efforts to improve upon Uniform Commercial Code article 6 (Bulk Transfers) appear to have reached fruition.[268] At its 1988 annual meeting, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") withdrew its support for article 6 and encouraged those states that have enacted the article to repeal it.

Recognizing that some legislatures may wish to continue to regulate bulk sales, but believing that existing article 6 has become inadequate for that purpose, NCCUSL promulgated a revised version of article 6. The revised article is designed to afford better protection to creditors while minimizing the impediments to good-faith transactions.

At its meeting in December 1988, the council of the American Law Institute ("ALI") approved the NCCUSL recommendations and forwarded them to the ALI membership for consideration at its meeting in May 1989.

As approved by NCCUSL, revised article 6 would substantially modify the law governing bulk transfers. The following are among the major changes the article, if enacted, will make:

> (i) The revised article will apply only when the buyer has notice, or after reasonable inquiry would have had notice, that the seller will not continue to operate the same or a similar kind of business after the sale.

267. The optional language first appears in ALI & NCCUSL, 1952 Official Draft of Text and Comments of the U.C.C. 46 (Supp. No. 1 Jan. 1955), *reprinted in* 17 U.C.C. Drafts, *supra* note 48, at 364. Prior to the printing of that supplement, the Commercial Code Committee of the Pennsylvania State Chamber of Commerce ("Chamber Committee") had submitted to the Editorial Board amendments to the U.C.C. The Chamber Committee's article 7 amendments were referred to the Editorial Board's Subcommittee on Article 7, which was chaired by Robert Braucher. Professor Braucher was to meet with a representative of the Chamber Committee to resolve those amendments. *See* Letter from H. Goodrich to Members of the Editorial Board (Dec. 15, 1954). Presumably the optional language resulted from the meeting between Braucher and the Chamber Committee's representative. In any event, Braucher was an active participant and was thus in a position to know why the optional language was added.

268. The early steps were taken by a subcommittee of the Uniform Commercial Code Committee of the ABA's Section of Corporation, Banking and Business Law. *See* Hawkland, *Proposed Revisions to U.C.C. Article 6,* 38 Bus. Law. 1729 (1983). In 1985, the National Conference of Commissioners on Uniform State Laws, in cooperation with the American Law Institute, established a drafting committee to revise article 6. *See generally* Harris, *The Article 6 Drafting Committee's New Approach to Asset Acquisitions,* 42 Bus. Law. 1261 (1987).

(ii) The revised article will not apply to sales in which the value of the property otherwise available to creditors is less than $10,000 or those in which the value of the property is greater than $25,000,000.

(iii) The choice-of-law provision will limit the applicable law to that of one jurisdiction.

(iv) When the seller is indebted to a large number of persons, the buyer will not need to obtain a list of those persons or send individual notices to each person but instead will be permitted to give notice by filing.

(v) The notice period will be increased from ten days to forty-five days, and the statute of limitations will be extended from six months to one year.

(vi) The required notice will include a copy of a "schedule of distribution," setting forth how the net contract price is to be distributed.

(vii) A buyer who makes a good faith effort to comply with the requirements of the revised article or to exclude the sale from the application of the article—or who acts on the good faith belief that the article does not apply to the sale—will not be liable for noncompliance.

(viii) A buyer's noncompliance will not render the sale ineffective or otherwise affect the buyer's title to the goods; rather, the liability of a noncomplying buyer will be for damages caused by the noncompliance.

In addition to making these and other major substantive changes, enactment of revised article 6 should resolve many of the ambiguities that three decades of law practice, judicial construction, and scholarly inquiry have disclosed.

One of the issues addressed in the revised article is whether the failure to give notice of an impending sale should toll the statute of limitations. Section 6-111 of the existing article tolls the normal six-month statute of limitations[269] if the bulk transfer "has been concealed." Some cases, including one decided during the survey period,[270] hold that failure to give notice of an impending bulk transfer constitutes concealment. Others consider the failure to give notice to be insufficient to toll the statute. They hold that a transfer is not "concealed" unless an affirmative act has been taken to shield the transfer from the creditor.[271] Revised article 6 adopts the latter approach and provides expressly that complete noncompliance with the requirements of the article does not of itself constitute concealment.

Existing article 6 imposes a number of risks that may not be readily apparent to buyers of business assets. The transactions in *Nichols Motorcycle Supply v.*

269. The statute of limitations applies to an "action under this Article." U.C.C. § 6-111. The court in Tisdall v. Tisdall, 422 N.W.2d 105, 6 U.C.C. Rep. Serv. 2d (Callaghan) 818 (S.D. 1988), held that this limitation is inapplicable to an action by a transferee in bulk against its agent for damages caused by the agent's failure to conduct the bulk transfer in accordance with the requirements of article 6.

270. Seminole Motors, Inc. v. American Nat'l Bank & Trust. Co. (*In re* Seminole Motors, Inc.), 86 Bankr. 245, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1092 (Bankr. E.D. Okla. 1987).

271. *See, e.g.*, Pipeline Materials, Inc. v. Turf Irrigation Corp., 754 P.2d 775, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1094 (Colo. Ct. App. 1988).

Regency Kawasaki, Inc.[272] indicate one of those risks. A motorcycle dealer sought to liquidate its business as follows. It transferred all its new motorcycles, having a value of $200,000, to the manufacturer in satisfaction of a secured debt. Thereafter, another dealer bought $30,000 of used and junk motorcycles, parts, and accessories, leaving the seller with $20,000 of inventory and equipment remaining. The court held that the sale to the dealer constituted the transfer of a "major part" of the inventory and was a bulk transfer under article 6.[273] Because the buyer failed to comply with the requirements of sections 6-104(1)(a) and (b), the court affirmed the trial court's ruling that the sale be set aside.

In determining whether the buyer bought a "major part" of the inventory, the court rejected the view that the buyer's portion should be measured against the total inventory held by the seller at the time it began to liquidate. Rather, the value of the inventory previously taken by the secured party was not to be included in the calculation. The moral of the story is clear: Each buyer at a self-liquidation should take care to determine how much inventory is "held" by the seller at the time of the sale to that buyer. Under the court's ruling, more than one bulk transfer may occur in the course of a self-liquidation. Moreover, the buyer of the inventory remaining at the end of a close-out sale will be required to comply with the requirements of article 6, regardless of the relationship between the value of the inventory purchased and the value of the inventory when the seller's business was a going concern. The result is likely to be the same under revised article 6.

Another risk lurking in article 6 may arise from the use of the "short-form" notice in section 6-107(1). In *Cullen Distributing, Inc. v. Petty*,[274] the transferee knew that the proceeds of the sale would be paid entirely to secured parties secured by the property transferred.[275] Nevertheless, the transferee sent "short-form" notices stating that "[a]ll debts . . . will be paid in full . . . as a result of this transaction . . . ."[276] The transferee did so based on the transferor's representation that he would pay his creditors from other funds. The court affirmed a judgment against the transferee and in favor of one of the transferor's creditors in the full amount of the creditor's claim against the transferor. The court found that, although the facts did not support application of a third party beneficiary theory, the trial court's finding for the creditor on the issue of promissory estoppel was not against the manifest weight of the evidence.

272. 295 S.C. 138, 367 S.E.2d 438, 6 U.C.C. Rep. Serv. 2d (Callaghan) 823 (S.C. Ct. App. 1988).

273. The court held this transfer to be excluded from article 6 by § 6-103(3), which excludes "[t]ransfers in settlement or realization of a lien or other security interests."

274. 164 Ill. App. 3d 313, 517 N.E.2d 733, 5 U.C.C. Rep. Serv. 2d (Callaghan) 1081 (1987).

275. Query whether the transfer was excepted from article 6 by virtue of § 6-103(3).

276. 164 Ill. App. 3d at 314, 517 N.E.2d at 734, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1082–83.

Of even greater concern to transferees in bulk is the opinion of Justice Lund, specially concurring.[277] By construing article 6 as imposing guarantor liability upon every transferee who uses the "short form" in favor of every creditor shown on the transferor's list, he would eliminate any need to determine whether the elements of promissory estoppel were met in each case. In contrast, Presiding Justice Green, concurring in part and dissenting in part, would have relied exclusively on promissory estoppel and would have reversed the judgment insofar as it awarded money damages for violation of article 6.[278] To avoid liability, the transferee should have used the "long-form" notice described in sections 6-107(1) and (2) and indicated doubt over whether the transferor's debts would be paid.

Revised article 6 eliminates the distinction between the "short form" and "long form" and contains a form of notice sufficient to meet the statutory requirements.

277. *Id.* at 323, 517 N.E.2d at 740, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1090 (Lund, J., specially concurring).

278. *Id.* at 324, 517 N.E.2d at 741, 5 U.C.C. Rep. Serv. 2d (Callaghan) at 1091 (Green, P.J., concurring in part, dissenting in part).

Article 2A—Leases

*By Lawrence F. Flick II**

Article 2A of the Uniform Commercial Code,[1] in its first full year after approval by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the American Law Institute, and the Permanent Editorial Board for the Uniform Commercial Code, has already been enacted in Oklahoma[2] and California.[3] Legislation to adopt article 2A is under consideration in at least twenty other states.[4]

As expected for a new statute, 1988 saw no reported cases involving article 2A, but the new article has been the subject of a number of law review articles.[5]

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1. All references to "article 2A" and the "official text" mean the 1987 Official Text of the Uniform Commercial Code.

2. Oklahoma's version of article 2A was enacted March 30, 1988, and became effective November 1, 1988. The statute is codified at Okla. Stat. tit. 12A, §§ 2A-101 to -531 (Supp. 1988). *See* Miller, Puckett & Suggs, *Leases in Oklahoma: The New Rules,* 41 Okla. L. Rev. 417 (1988).

3. California's version of article 2A was enacted on September 16, 1988, and will become effective January 1, 1990. The statute is codified at Cal. Com. Code §§ 10101–10532 (West Supp. 1989).

4. Alaska, Florida, Illinois, Maine, Massachusetts, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New York, North Dakota, Oregon, Rhode Island, South Dakota, Utah, Washington, and West Virginia. Also in 1988, article 2A was approved by the Delaware House but failed to pass the Senate; it was withdrawn for further consideration in Connecticut. Several other states intend to introduce article 2A in 1989 and are currently studying the statute. In August 1988, the American Bar Association approved article 2A but recognized in its resolution that due consideration would be given during the enactment process to divergent views as in the case of amendments proposed by the California Commission on Uniform State Laws.

5. Article 2A was the subject of coverage in this Annual Survey last year. Bayer, *Personal Property Leasing: Article 2A of the Uniform Commercial Code,* 43 Bus. Law. 1491 (1988). *See also Symposium: Article 2A of the Uniform Commercial Code,* 39 Ala. L. Rev. 559 (1988); Cooper, *Personal Property Leasing Under Article 2A,* in Equipment Leasing—Leveraged Leasing 1047 (Practising Law Institute 1988); Naples, *A Review and Analysis of the New Article 2A—Leases Amendment to the UCC and Its Impact on Secured Creditors, Equipment and Finance Lessors,* 93 Com. L.J. 342 (1988); Herbert, *A Draft Too Soon: Article 2A of the Uniform Commercial Code,* 93 Com. L.J. 413 (1988); Miller, Puckett & Suggs, *Leases of Goods in Oklahoma: The New Rules,* 41 Okla. L. Rev. 417 (1988); Comment, *Security Interests under Article 2A: More Confusion in the Leasing Arena,* 18 Stetson L. Rev. 69 (1988); Note, *Uniform Commercial Code: Article 2A—Leases: Structuring Priorities of Competing Claimants to Leased Property,* 73 Minn. L. Rev. 208 (1988).

While most of the commentators view article 2A favorably and support its adoption by the individual states, many have pointed out various glitches in the statute and have been critical of specific provisions.[6] In response to a number of these criticisms and others raised by leasing industry trade groups and members of the bar, California adopted a version of article 2A containing a number of nonuniform amendments to the official text of article 2A ("California 2A").[7] The California nonuniform amendments were by far the most significant development affecting article 2A in 1988 and are likely to provoke thought and controversy in other state legislatures considering adoption of article 2A. The Massachusetts legislature, for example, is presently considering a version of article 2A that contains a number of revisions based on California 2A.[8]

The California nonuniform amendments resulted primarily from the efforts of the Uniform Commercial Code Committee of the Business Law Section of the State Bar of California and lobbying efforts by equipment lessors and trade groups located in California. That bar committee studied article 2A and issued a detailed report recommending amendments to several sections of the uniform law ("California Bar Report").[9] In response to the enactment of California 2A and efforts to introduce similar nonuniform amendments in other states, the Standby Committee on Uniform Commercial Code Article 2A, appointed by NCCUSL, reviewed the nonuniform amendments enacted in California 2A and responded with a detailed report entitled *The California Amendments to UCC Article 2A* ("Standby Committee Report").[10] The Standby Committee Report urges those states considering article 2A to reject the California nonuniform

6. *See, e.g.,* Rapson, *Deficiencies and Ambiguities in Lessors' Remedies Under Article 2A: Using Official Comments to Cure Problems in the Statute,* 39 Ala. L. Rev. 875, 876 (1988) ("Despite the difficulties in interpreting and applying Article 2A . . ., the statute represents a significant improvement over the present state of uncertainty and confusion that marks personal property leasing law"); Alces, *Surreptitious and Not-So-Surreptitious Adjustment of the UCC: An Introductory Essay,* 39 Ala. L. Rev. 559, 573 (1988) ("Most of the other contributors to this symposium . . . are generally favorable in their assessment of Article 2A's provisions and qualify their criticisms with remarks praising the overall quality of the effort."); Benfield, *Lessor's Damages Under Article 2A After Default by the Lessee As to Accepted Goods,* 39 Ala. L. Rev. 915, 956 (1988) ("The glitches in the statute and the unresolved questions [concerning lessor's remedies] are not by any means sufficient to raise serious questions about whether Article 2A should be adopted."). *But see* Herbert, *supra* note 5, at 414 (criticizing article 2A for its failure to deal with the problem of ostensible ownership by the lessee and with the special problems created by consumer leasing and for poor draftsmanship.); Kripke, *Some Dissonant Notes About Article 2A,* 39 Ala. L. Rev. 791, 801 (1988) (opposing promulgation of article 2A).

7. Cal. Com. Code §§ 10101–10532. Oklahoma has enacted article 2A with only minor amendments, which mostly reflect differences in Oklahoma law. *See supra* notes 2–3 and accompanying text.

8. Mass. H.R. 6269 (1988) [hereinafter Massachusetts Bill].

9. California State Bar Report, *reprinted in* 39 Ala. L. Rev. 979 (1988).

10. NCCUSL, The California Amendments to UCC Article 2A (1989) [hereinafter Standby Committee Report]. A copy of the report may be obtained from the National Conference of Commissioners on Uniform State Laws, 676 North St. Clair Street, Suite 1706, Chicago, Illinois 60611.

amendments; it recommends that the official text of article 2A be introduced and enacted.[11]

This survey will highlight some of the significant differences between the official text of article 2A and California 2A and will summarize the debate between the proponents of the competing versions of the statute.[12]

DEFINITION OF FINANCE LEASE

Article 2A contains a number of special statutory provisions which benefit a lessor under a "finance lease."[13] If a lease qualifies as a finance lease under article 2A, the lessor is automatically given the benefit of a statutory equivalent of a "hell-or-high-water" clause[14] and does not give any of the implied warranties provided in article 2A other than an implied warranty of quiet enjoyment.[15] In addition, the lessee under a finance lease automatically becomes the beneficiary of all warranties made in the underlying supply contract for the leased property.[16] Article 2A defines a "finance lease" as:

> [A] lease in which (i) the lessor does not select, manufacture or supply the goods, (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease, and (iii) either the lessee receives a copy of the contract evidencing the lessor's purchase of the goods on or before signing the lease contract, or the lessee's approval of the contract evidencing the lessor's purchase of the goods is a condition to effectiveness of the lease contract.[17]

Based on concerns expressed by some equipment lessors that it is neither feasible nor desirable in some transactions to supply the lessee with a copy of the supply contract, California 2A expands the ways in which a lessor can have its lease qualify as a statutory finance lease.[18] Under California 2A a lease also qualifies as a finance lease if the lease contract discloses all warranties provided

11. In response to the Standby Committee Report, *supra* note 10, Donald J. Rapson and Harry C. Sigman authored a section by section analysis of the nonuniform amendments adopted in California and introduced in the Massachusetts Bill. D. Rapson & H. Sigman, Reasons for Revisions (as set forth in mark-up dated January 24, 1989 of Mass. H.R. 6269) (Feb. 23, 1989) [hereinafter Reasons for Revisions].

12. This survey will not discuss amendments in California's article 2A that are local in nature, reflect differences in existing California law, or are merely stylistic.

13. *See, e.g.*, U.C.C. §§ 2A-209(2), 2A-212(1), 2A-213, 2A-219(1), 2A-220(1)(a), 2A-221, 2A-405(c), 2A-407, 2A-516(2), 2A-517(1)(a).

14. *Id.* § 2A-407. The phrase refers to the fact that under this section—as under contract clauses to the same effect—the lessee's obligations to the lessor under a three-party "finance lease" become "irrevocable and independent upon the lessee's acceptance of the goods." *Id.*

15. *Id.* §§ 2A-211(2) (warranty against infringement), 2A-212(1) (warranty of merchantability), 2A-213 (warranty of fitness for a particular purpose).

16. *Id.* § 2A-209(1).

17. *Id.* § 2A-103(1)(g).

18. Standby Committee Report, *supra* note 10, at 2. The lessor might not want to disclose to the lessee a favorable price or other terms negotiated with the supplier of the goods. Also, there may be instances where there is no written supply contract.

in the supply contract, or if the lessor informs the lessee in writing of the identity of the supplier and of the fact that the lessee may have rights under the supply contract, and advises the lessee to contact the supplier for a description of such rights.[19]

The Standby Committee Report takes the position that this California nonuniform amendment is unnecessary and that a lessor can obtain the benefits of statutory finance lease status by adequately disclaiming warranties and including a typical hell-or-high-water clause in the lease. As the Standby Committee Report further points out, even a lease transaction involving an oral supply contract, if approved by the lessee, can qualify as a "finance lease."[20]

The Massachusetts bill contains a further refinement of the California 2A definition of a finance lease. This would permit the lessor to qualify its lease as a finance lease by directing the lessee to the supplier, but only if the lease is not a consumer lease and the appropriate information is provided to the lessee on or before the date the lease contract is signed.[21]

A second nonuniform amendment relating to finance leases is found in California section 2A-407(3).[22] This California amendment is intended to make clear that the limited statutory hell-or-high-water provision contained in section 2A-407(3) does not in any way limit the validity of a contractual hell-or-high-water clause in the lease contract under other applicable law.[23] The Standby Committee Report's response to this amendment is that "this dubious concern is

19. California's version of § 2A-103(1)(g) qualifies a lease as a "finance lease" where:

> (iii) either (A) the lessee receives a copy of the contract evidencing the lessor's purchase of the goods on or before signing the lease contract, (B) the lessee's approval of the contract evidencing the lessor's purchase of the goods is a condition to effectiveness of the lease contract, (C) the lessor (aa) informs the lessee in writing of the identity of the supplier unless the lessee has selected the supplier and directed the lessor to purchase the goods from the supplier, (bb) informs the lessee in writing that the lessee may have rights under the contract evidencing the lessor's purchase of the goods, and (cc) advises the lessee in writing to contact the supplier for a description of any such rights, or (D) the lease contract discloses all warranties and other rights provided to the lessee by the lessor and supplier in connection with the lease contract and informs the lessee that there are no warranties or other rights provided to the lessee by the lessor and supplier other than those disclosed in the lease contract.

Cal. Com. Code § 10103(1)(g) (West Supp. 1989).

20. Standby Committee Report, *supra* note 10, at 3. The California Bar Report agrees that a lessor could obtain satisfactory protection by contractually providing for the benefits of a statutory "finance lease." California Bar Report, *supra* note 9, at 997.

21. The Massachusetts Bill provides that a lease qualifies as a "finance lease":

> (D) only if the lease is not a consumer lease, on or before the signing of the lease contract by the lessee the lessor (aa) informs the lessee in writing of the identity of the supplier unless the lessee has selected the supplier and directed the lessor to purchase the goods from the supplier, (bb) informs the lessee in writing that the lessee may have rights under the contract evidencing the lessor's purchase of the goods, and (cc) advises the lessee in writing to contact the supplier for a description of any such rights.

22. Cal. Com. Code § 10407(3) (West Supp. 1989).

23. The added subsection provides:

laid to rest by the Comment to Section 2A-407; the California amendment simply codifies the Comment."[24]

TRANSFER OF LESSOR'S INTEREST

Article 2A permits either party to a lease to transfer its interest under the lease contract, including the lessor's residual interest in the leased property.[25] There are two exceptions to this general rule on free alienability. The first, contained in section 2A-303(1)(a), prohibits voluntary transfers if the lease contract prohibits such a transfer.[26] The second, found in section 2A-303(1)(b), prohibits both voluntary and involuntary transfers if (i) the transfer materially changes the duty of or materially increases the other party's burden of risk, and (ii) the other party to the lease has made a timely demand for cure or adequate assurances of performance and such cure or assurances are not provided.[27] Questions have been raised as to the wisdom of imposing such a restraint on the free alienability of the lessor's interest under the lease and the lessor's residual interest in the leased property, because such a restraint could affect the lessor's ability to obtain secured financing.[28] These concerns gave rise to nonuniform amendments to section 2A-303 in California.[29]

Under California 2A, an attempt to prohibit the transfer of the lessor's interest under a lease or of the lessor's residual interest in the leased property does not invalidate the creation and enforcement of any security interest granted by the lessor.[30] The Standby Committee Report, responding to this amendment, points out that official section 2A-303 already recognizes that a lessee has an interest in controlling the identity of the lessor who may be obligated to render

> (3) This section shall not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

Id.

24. *See* Standby Committee Report, *supra* note 10, at 10. The comment to § 2A-407 states, "This section is silent as to whether a 'hell-or-high-water' clause, i.e., a clause that is to the effect of this Section, is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of each case." U.C.C. § 2A-407 official comment. One commentator has suggested that the comments to § 2A-407 on this issue are "not merely ambiguous; they are internally self-contradictory." Herbert, *supra* note 5, at 461 (reference is to another part of the comments, which states that § 2A-407 "excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law . . ., state statute . . ., or federal statute.").

25. U.C.C. § 2A-303(1).

26. *Id.* § 2A-303(1)(a). Subsection (7) of § 2A-303 requires that any prohibition on the transfer of an interest of a party under the lease be specific, in writing, and conspicuous.

27. *Id.* § 2A-303(1)(b).

28. Harris, *The Rights of Creditors Under Article 2A,* 39 Ala. L. Rev. 803, 843–44, 849–50 (1988); Miller, Puckett & Suggs, *supra* note 2, at 436–37; Bayer, *supra* note 5, at 1491, 1506.

29. California has also revised U.C.C. § 9-318(4) to make it clear that a term in a contract prohibiting or requiring consent to the creation of a security interest in chattel paper is ineffective. Cal. Com. Code § 9318 (West Supp. 1989).

30. *Id.* § 10303(3)(a) (West Supp. 1989). *See* Reasons for Revisions, *supra* note 11, at 3.

substantial performance affecting the value of the lease, and that the lessor can address its concerns in the lease contract.[31] The California amendments, recognizing that a sale of the residual interest upon the lessor's default might create a significant burden for the lessee, retain the restraint on alienability found in official section 2A-303(1)(b), where the transfer is the result of a sale under sections 9-504 or 9-505 of the Uniform Commercial Code.[32]

Finally, California 2A adds a new subsection to section 2A-303. This expressly provides that the restraints on alienability found in section 2A-303(1)(b) do not affect the validity of any provision in the lease obligating the lessee to keep its interest in the lease or the leased property free of liens and encumbrances.[33]

RIGHTS OF CREDITOR TRANSFEREES

Section 2A-307 provides that a creditor of a lessor takes subject to the lease contract unless (i) the creditor has a lien that attached to the leased property prior to the time the lease became enforceable against the lessee or (ii) the creditor has obtained a security interest in the leased property that would have priority over a competing security interest in the same leased property perfected under article 9 at the time the lease became enforceable against the lessee.[34] In any event, a lessee in the ordinary course of business will generally take the leased property free of any security interest created by the lessor.[35]

Commentators have criticized the rule in section 2A-307(2)(b) that resolves priority disputes between a secured creditor of the lessor and a lessee not in the ordinary course of business by reference to a "hypothetical secured party" test.[36] The main criticism is that treatment of the interest of a lessee *not* in the ordinary course of business under section 2A-307(2)(b) is inconsistent with the result reached for a buyer not in the ordinary course of business under article 9. Section 9-301(1)(c) provides that a buyer not in the ordinary course of business takes free of an unperfected security interest if the buyer takes delivery and

31. Standby Committee Report, *supra* note 10, at 3, 4 (citing Harris, *supra* note 28, at 855). As one example of a situation where the identity of the lessor is extremely important to the lessee, Professor Harris points out that the sale of a lessor's residual interest in an aircraft after default to a foreign entity could render the aircraft ineligible for registration and thus unusable by the lessee. Harris, *supra* note 28, at 853.

32. Reasons for Revisions, *supra* note 11, at 3.

33. Cal. Com. Code § 10303(3)(d) (West Supp. 1989). Proponents of California's § 2A-303(3)(d) have expressed a concern that "2A-303(1)(b) is otherwise not clear as to the effectiveness of such a provision where there is an involuntary transfer of the lessee's interest, e.g., levy and execution sale by a judgment creditor of the lessee." Reasons for Revisions, *supra* note 11, at 4. The Standby Committee Report recognizes and agrees that § 2A-303(1) is not explicit on the issue of whether seizure of the lessee's interest under the lease can be made an event of default, but the report points out that nothing expressly states that it cannot be made a default. The Standby Committee Report also agrees that California 2A correctly states the result that should be reached under the official text. Standby Committee Report, *supra* note 10, at 10.

34. U.C.C. § 2A-307(2).

35. *Id.* § 2A-307(3).

36. *See, e.g.*, Harris, *supra* note 28, at 818–20.

gives value without knowledge of the security interest.[37] Under official article 2A, however, the lessee's knowledge of the security interest created by the lessor is not relevant in determining priorities.

California 2A replaces the "hypothetical secured party" rule with a test that is consistent with article 9. It provides that the secured party will have priority unless the lessee gives value and takes possession of the leased property without knowledge of the security interest.[38] The Standby Committee Report says that the California amendments may prove unfair to certain lessees, for example a lessee who has leased equipment subject to a purchase money security interest which is not perfected at the time the lessee entered into the lease and took possession of the leased property, but is perfected within twenty days after either the lessor or lessee receives possession of the leased property.[39] Under the official text, the lessee in this example would take free of the purchase money security interest even if the lease was not in the ordinary course of business. Under the variation in California 2A, if the lease is not in the ordinary course of business, the lessee will take subject to the purchase money security interest.

DEFAULT

Article 2A contains a number of statutory defaults, including nondelivery, wrongful rejection or revocation of acceptance, failure to make payment when due, and repudiation.[40] Sections 2A-508 and 2A-523 list specific remedies that the aggrieved lessee or lessor may exercise upon the occurrence of one of these statutory defaults.[41] Section 2A-523(2) provides that "if a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and remedies

37. U.C.C. § 9-301(1)(c).

38. California's § 2A-307(2) provides that a creditor of the lessor takes subject to the lease contract:

> (a) Unless the creditor holds a lien that attached to the goods before the lease contract became enforceable;
> (b) Unless the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest; or
> (c) Unless the creditor holds a security interest in the goods that attached and was perfected before (i) the lease contract became enforceable, (ii) the lessee gave value and received delivery of the goods, or (iii) in the case of a purchase money security interest, the date that is 20 days after the date that the lessor received possession of the goods or the date that the lessee received possession of the goods, whichever is earlier.

Cal. Com. Code § 10307 (West Supp. 1989).

39. Standby Committee Report, *supra* note 10, at 4.

40. U.C.C. §§ 2A-508, 2A-523.

41. A lessee's remedies upon the occurrence of a statutory default by the lessor include the right to cancel the lease, the right to recover any rent and security deposits paid, the right to cover and recover damages, the right to recover goods identified to the contract and, in proper cases, the right to obtain specific performance or replevy of the goods. *Id.* §§ 2A-508, 2A-509, 2A-505, 2A-518 to -522. The lessor's remedies upon the occurrence of a statutory default by the lessee include the right to cancel the lease contract, the right to proceed with respect to goods not identified to the lease contract, the right to withhold delivery of goods and to take possession of goods previously delivered, the right to stoppage in transit, the right to dispose of goods and recover damages, the right to retain

provided in the lease contract and this Article."[42] A corresponding provision is found in section 2A-508 with respect to the lessee's rights against a defaulting lessor.[43]

The California Bar Report points out that these subsections are misleading in their use of the term "otherwise in default" and suggests that the statutory remedies provided in part 5 of article 2A should be available following *any* default agreed to in the lease.[44] There is also disagreement as to whether a party to a lease may provide in the lease contract that all of the remedies of article 2A apply upon the occurrence of any default in the lease contract, or whether the lease must expressly state the remedies that apply to a default that is not a statutory default.[45]

California 2A does not articulate the California Bar Report's suggestion that the remedies in part 5 should apply to all defaults; instead it was modified to make clearer that the statutory remedies in part 5 of article 2A are only available for the statutory defaults defined in subsection (1) of both sections 2A-508 and 2A-523, but that they can also be made applicable by agreement to other contractual defaults.[46] The Massachusetts bill has followed the original suggestion in the California Bar Report, providing that the statutory rights and remedies provided for in article 2A are available for any default contractually provided for in the lease unless the lease otherwise provides. This would enable the lessee or lessor simply to incorporate by reference all of the rights and remedies of article 2A.[47]

REMEDIES AND DAMAGES

One of the primary original reasons for drafting a uniform personal property act was to clarify the confusing and often conflicting treatment that various courts gave lessor remedies and damages upon the lessee's default.[48] While there is a virtual consensus that the remedy and damage provisions in part 5 of article 2A are a vast improvement over the prior state of the law,[49] the provisions

the goods and recover damages, or in a proper case, the right to recover accelerated rent. *Id.* §§ 2A-523 to -531, 2A-505.

42. *Id.* § 2A-523(2).

43. *Id.* § 2A-508(2).

44. California Bar Report, *supra* note 9, at 1036.

45. Benfield, *supra* note 6, at 917 n.9; Herbert, *supra* note 5, at 439–41.

46. Cal. Com. Code § 10523 (West Supp. 1989).

47. Reasons for Revisions, *supra* note 11, at 6, 8.

48. Mooney, *Personal Property Leasing: A Challenge,* 36 Bus. Law. 1605, 1615 (1981) ("Existing law dealing (and failing to deal) with the nonbankruptcy enforcement of leases of personal property, and the available remedies and damages upon the lessee's breach, may be the area most in need of the therapeutic effects of uniform statutory treatment."); Boss, *Panacea or Nightmare? Leases in Article 2,* 64 B.U.L. Rev. 39, 78 (1984); Huddleson, *Old Wine in New Bottles: UCC Article 2A—Leases,* 39 Ala. L. Rev. 615, 641 (1988).

49. *See, e.g.,* Miller, Puckett & Suggs, *supra* note 2, at 440 ("Perhaps Article 2A's greatest contribution to Oklahoma law concerns remedies."); Benfield, *supra* note 6, at 956 ("The Article 2A provisions as to the lessor's remedies on the lessee's breach are sufficiently varied and flexible, particularly when subjected to the Code's overriding doctrines of good faith, that courts should be

dealing with lessor remedies and damages have been the brunt of much of the criticism directed at article 2A.[50] Some of the criticism of the article 2A provisions on remedies and damages is attributable to the drafters' decision to follow the remedy and damage provisions of article 2 (Sales) of the Uniform Commercial Code.[51] The Drafting Committee tried to address many of these criticisms in a revised set of official comments to article 2A.[52] However, concern remained that such efforts to clarify the text of the statute through the use of official comments are inappropriate.[53] In response to these criticisms of the lessor remedy and damage provisions in article 2A and to recommendations in the California Bar Report,[54] California enacted nonuniform versions of sections 2A-527, 2A-528, and 2A-529.[55]

The official text provides that the lessor, after a statutory default, may dispose of the leased goods by lease, sale, or otherwise.[56] If the lessor repossesses the goods and re-leases them under an agreement substantially similar to the original lease,[57] section 2A-527 provides that the lessor may recover the sum of (i) accrued but unpaid rent, as of the date of default; (ii) the present value, as of the date of default, of the difference between the total remaining rent payments due under the lease and the total rent payable under the substantially similar lease; and (iii) any incidental damages resulting from the lessee's default, less any expenses saved in consequence of the default.[58] If the lessor repossesses the

able to reach fair and predictable results."); Naples, *supra* note 5, at 353 ("the Article 2A committee took special note of not only the dissatisfaction which lessors have characteristically displayed with regard to the remedies available to them in the event of a lessee's default but also of how such remedies might be enforced by a lessor given the history of judicial inconsistency in the remedies area").

50. *See, e.g.,* Herbert, *supra* note 5, at 463 (article 2A "remedy provisions are disastrously ill-coordinated"); California Bar Report, *supra* note 9, at 1035–45; Reasons for Revisions, *supra* note 11, at 9–13; Kripke, *supra* note 6, at 795–97; Rapson, *supra* note 6, at 887; Benfield, *supra* note 6, at 795.

51. *See, e.g.,* Kripke, *supra* note 6, at 795 ("desire to follow Article 2 muddles § 2A-529 on the lessor's right to sue for rent"); Rapson, *supra* note 6, at 887 ("by replicating the structure and formulation of the Article 2 remedies . . ., Article 2A has created interpretative problems . . .").

52. Rapson, *supra* note 6, at 880.

53. *Id.* at 877–79, 912; Kripke, *supra* note 6, at 796 ("a defect or ambiguity in the statute should be cured *in the statute,* not by writing Official Comments which are neither formally adopted by the two sponsor organizations nor enacted by legislatures"); California Bar Report, *supra* note 9, at 984 (" 'legislation by comment' is not only inappropriate but also, in this case, unlikely to be successful").

54. California Bar Report, *supra* note 9, at 984–85, 1036–43.

55. Cal. Com. Code §§ 10527–10529 (West Supp. 1989). Corresponding revisions were made to §§ 2A-508 and 2A-519 dealing with a lessee's remedies upon the lessor's default. *Id.* §§ 10508, 10519.

56. U.C.C. § 2A-527.

57. Provided the new lease agreement is entered into in good faith and in a commercially reasonable manner. U.C.C. § 2A-527 does not provide an absolute rule as to when a new lease should be considered substantially similar to the original lease. The official comment to the section describes some of the factors that should be considered but leaves the decision to the courts for determination on a case by case basis.

58. U.C.C. § 2A-527.

goods and disposes of them in any manner other than by re-lease under a substantially similar agreement, then section 2A-528 provides that the lessor may recover the sum of (i) accrued but unpaid rent, as of the date of default; (ii) the present value, as of the date of default, of the difference between the total remaining rent payments due under the lease and the "market rent" for the same period; and (iii) any incidental damages resulting from the lessee's default less any expenses saved in consequence of the default.[59]

The sections of the statute which specify damages as of the date of default have been criticized for being unfair to the lessor because there will likely be a gap between the date of default and the date the lessor obtains possession of the goods and is able to dispose of them.[60] Under article 2A, during this gap period the lessor would not be able to recover the agreed upon rent but would only be entitled to the present value of the difference between the remaining rental payments and (depending on whether section 2A-527 or section 2A-528 is applicable) either the total rent under the new lease or the "market rent."

In response to this criticism, California 2A provides that damages are determined "as of the date of the commencement of the term of the new lease agreement" where the lessor has elected to re-lease the goods under a substantially similar lease,[61] and "as of the date the lessor obtained possession of the goods or such earlier date as the lessee has made an effective tender of possession of the goods back to the lessor" where the lessor has elected to dispose of the goods by some other means.[62] The Standby Committee Report expresses concern that these California variations permit the lessor to benefit from delay.[63] The Reasons for Revisions respond by pointing out that if the lessor delays in repossessing the goods under California section 2A-507, the substitute lease will not be made in good faith and in a commercially reasonable manner, and that under California section 2A-508 the lessee can tender possession of the goods back to the lessor at an earlier date, thus fixing the date used to determine damages.[64] The Standby Committee Report also minimizes these concerns because under "well defined law"outside of article 2A, the lessee would be liable for losses due to the delay.[65]

59. *Id.* § 2A-528.

60. *See, e.g.,* Rapson, *supra* note 6, at 895–96, 911; California Bar Report, *supra* note 9, at 1039; Herbert, *supra* note 5, at 452.

61. Cal. Com. Code § 10527(2) (West Supp. 1989).

62. *Id.* § 10528(1). California's § 2A-528(1) also provides that "market rent" is determined as of the date the lessor obtains possession of the goods or such earlier date as the lessee tenders possession of the goods back to the lessor "and at the place where the goods were located on that date." *Id.* The official text provides that "market rent" is determined "at the time and place for tender." U.C.C. § 2A-528(1). Commentators have pointed out that the official text is not clear, unless read in conjunction with the comments. *See, e.g.,* Benfield, *supra* note 6, at 932–34. The Standby Committee Report states that this California nonuniform amendment "essentially codifies the comments to the section." Standby Committee Report, *supra* note 10, at 11.

63. Standby Committee Report, *supra* note 10, at 5.

64. Reasons for Revisions, *supra* note 11, at 9–10.

65. Standby Committee Report, *supra* note 10, at 5; Miller, Puckett & Suggs, *supra* note 2, at 444–45. The authors state that "under established law outside of Article 2A the lessee will be liable

Commentators have criticized article 2A for being unclear as to whether the damage formula in section 2A-527 is simply an alternative to that in section 2A-528 where the goods are re-leased under a "substantially similar" lease.[66] California 2A clarifies that where a lessor has chosen to re-lease the goods under a "substantially similar" lease agreement, that lessor may elect to recover damages either under the "market rent" rule in section 2A-528, or based on the rent from the substantially similar lease under section 2A-527.[67] The Standby Committee Report finds that the statute and the comments to sections 2A-527, 2A-528, and 2A-523 "strongly support" the interpretation that the lessor may use either section, but the report goes on to state that, by putting this directly in the statute, California 2A creates "inflexibility" which "could do more harm than good."[68]

Section 2A-528(2) provides an alternative measure of damages where the measure provided in section 2A-528(1) is "inadequate to put the lessor in as good a position as performance would have."[69] A lessor that qualifies under this section is entitled to lost profits, including overhead, reduced by payments and proceeds of any disposition of the leased property.[70] Although the comment to the section makes it clear that the concept of present value should be applied in calculating profit,[71] commentators have been critical of the failure of the statute itself to so provide.[72] California 2A addresses this concern by expressly providing that the lessor is only entitled to the "present value of the profit."[73]

In some cases where the lessor elects to retain the goods for the remainder of the lease term rather than dispose of them, official section 2A-529 provides that the lessor may recover the sum of (i) accrued and unpaid rent as of the date of default, (ii) the present value of the remaining lease payments as of the date of default, and (iii) any incidental damages resulting from the lessee's default, less

for any loss due to the delay, and such would appear to qualify as an example of incidental damages which the lessor may recover." *Id.* The Standby Committee Report also cites to the comment to § 2A-505, which provides that "principles of law and equity with respect to the protection of [the lessor's reversion of any interest in the goods] . . . apply in many instances, e.g., refusal of the lessee to return goods to the lessor after termination or cancellation of the lease." Standby Committee Report, *supra* note 10, at 5. Proponents of California 2A have expressed concern that the correct interpretation of the text of § 2A-527(2) should not require reliance on the comment to § 2A-525. Reasons for Revisions, *supra* note 11, at 9.

66. *See, e.g.,* Rapson, *supra* note 6, at 898 n.73.

67. Cal. Com. Code §§ 10527(3), 10528(1) (West Supp. 1989).

68. Standby Committee Report, *supra* note 10, at 11 (citing J. White & R. Summers, Uniform Commercial Code 271–73 (2d ed. 1980)).

69. U.C.C. § 2A-528(2). The section is modeled after U.C.C. § 2-708(2) applicable to "lost volume sellers." *Id.* § 2A-528 comment.

70. *Id.* § 2A-528(2).

71. *Id.* § 2A-528(2) comment.

72. Herbert, *supra* note 5, at 455.

73. Cal. Com. Code § 10528(2) (West Supp. 1989). The Standby Committee Report states that this amendment to the official text "simply codifies the comment to 2A-528." Standby Committee Report, *supra* note 10, at 12.

any expenses saved in consequence of the default.[74] In response to the same criticisms made to sections 2A-527 and 2A-528 regarding the determination of damages as of the date of default,[75] California 2A provides that the measure of damages under section 2A-529 is determined "as of the date of entry of judgment in favor of the lessor."[76]

In addition, California 2A responds to criticisms that section 2A-529 does not require the lessor to mitigate damages,[77] by requiring mitigation in all cases unless the leased property has been retained by the lessee.[78] The Standby Committee Report takes the position that the question of whether a lessor should be required to mitigate damages should be left to general legal principles applied on a case by case basis.[79] The Standby Committee Report also reasons that if a lessor retains the goods for the remainder of the lease term without disposing of or using them, it is probably because there is no market for the goods, making mitigation impossible.[80]

The California Bar Report and various other commentators have also pointed out the potential for abuse under section 2A-529(1)(a) if a lessor disposes of the goods after obtaining a judgment against the lessee but before the expiration of the lease term.[81] Under such circumstances official section 2A-529(3) provides that a lessor's damages are then governed by sections 2A-527 and 2A-528.[82] The commentators are concerned that the lessor in such a situation will seek to enforce the full amount of its judgment, without giving the lessee credit for the difference between damages calculated under either section 2A-527 or section 2A-528 and the amount of the judgment which was based on damages calculated under section 2A-529.[83] The California Bar Report also opposes the official text of section 2A-529(1) because it relies on "a non-existent procedure for conducting a post-judgment proceeding to establish a market rent measure of damages" under section 2A-528, and for its "unrealistic and inefficient" expec-

74. U.C.C. § 2A-529. To recover under this section, the goods must have been accepted by the lessor. *Id.*

75. *See* text accompanying notes 59–60, *supra.*

76. Cal. Com. Code § 10529(1)(a), (b) (West Supp. 1989).

77. Rapson, *supra* note 6, at 900–03, 908–09; Benfield, *supra* note 6, at 936. One commentator has suggested that the official text is unclear as to whether the lessor is under a duty to mitigate, suggesting that an argument can be made that mitigation is required unless "the lessor is unable after reasonable effort to dispose of [the leased goods] at a reasonable price or the circumstances reasonably indicate that effort will be unavailing." Naples, *supra* note 5, at 356–57 (quoting U.C.C. § 2A-529(1)(b)). *See also* Herbert, *supra* note 5, at 456.

78. Cal. Com. Code § 10529(1).

79. Standby Committee Report, *supra* note 10, at 5 (citing Benfield, *supra* note 6, at 936–50). Professor Benfield suggests that the implied obligation of good faith found in the Code and common law principles applicable to transactions governed by article 2A should require the lessor to mitigate damages. Benfield, *supra* note 6, at 938–40.

80. Standby Committee Report, *supra* note 10, at 6.

81. *See, e.g.,* California Bar Report, *supra* note 9, at 1042; Rapson, *supra* note 6, at 906–07; Herbert, *supra* note 5, at 456–57.

82. U.C.C. § 2A-529(3).

83. Rapson, *supra* note 6, at 906–07.

tation that a lessee would seek to restrain a lessor's enforcement of its judgment to determine whether the lessor is still in possession of the leased property.[84]

California 2A addresses these concerns by expressly requiring the lessor to "cause an appropriate credit to be provided against any judgment for damages to the extent that the amount of the judgment exceeds the recovery available pursuant to Section 10527 or 10528."[85] In explaining why the California nonuniform amendment is not necessary, the Standby Committee Report points out that in the event a lessor does not give the lessee a proper credit on a postjudgment disposition of the leased property, the lessor would be liable to the lessee for wrongful levy.[86] The Standby Committee Report also notes that, even under California 2A, the burden is still on the lessee to initiate action against the lessor to enforce its rights if the lessor fails properly to amend its judgment.[87]

The final nonuniform California amendment to article 2A involves subsection 4 of section 2A-529. The official text provides that once the lessee has satisfied a judgment obtained by the lessor, it may use any goods not disposed of by the lessor for the remaining term of the lease.[88] California's section 2A-529(4) contains the additional provision that such a lessee must comply with all of the other terms and conditions of the lease while it is in possession of the leased goods.[89]

LESSOR'S RESIDUAL VALUE

Article 2A deals with the interests of the lessor and the lessee under a lease contract and not with the lessor's residual interest in the leased property. While the lessor's rights in and to the residual interest in the leased property are discussed in the official comments to article 2A,[90] the California Bar Report expresses a concern that there is no specific reference to the lessor's residual interest in the official text of article 2A.[91] To address this concern, California 2A adds a new section to the statute which provides that:

> In addition to any other recovery permitted by this division, the lessor shall be entitled to recover from the lessee an amount that will fully compensate

84. California Bar Report, *supra* note 9, at 1042.

85. Cal. Com. Code § 10529(3) (West Supp. 1989).

86. Standby Committee Report, *supra* note 10, at 6 (citing Miller, Puckett & Suggs, *supra* note 2, at 439 n.211 (pointing out that a lessor that does not give the lessee credit, but enforces the entire judgment, would be liable for wrongful levy, entitling the lessee to consequential and punitive damages)). *See also* U.C.C. § 2A-523 comment 11 (providing that the nature of post-judgment proceedings to reduce the judgment to the amount recoverable under § 2A-527 or § 2A-528 and the sanctions for any abuse by the lessor are to be determined by other law).

87. Standby Committee Report, *supra* note 10, at 6.

88. U.C.C. § 2A-529(4).

89. Cal. Com. Code § 10529(4). The Standby Committee Report states that this amendment "makes explicit what is implicit." Standby Committee Report, *supra* note 10, at 13.

90. *See, e.g.*, U.C.C. §§ 2A-525, 2A-528 comments.

91. California Bar Report, *supra* note 9, at 1045.

> the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee.[92]

The Standby Committee Report takes the position this new section is unnecessary and that the protection of a lessor's residual interest in the leased property should be left to "well-established property and other law" outside of the Uniform Commercial Code.[93]

92. Cal. Com. Code § 10532.

93. Standby Committee Report, *supra* note 10, at 5 (finding that California's § 10532 is "an attempt to create a less than level playing field for the lessee" and recommending that it not be followed).